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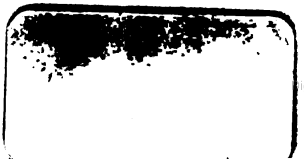

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Canada

Economic Position and for Development

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Economic Position and Plans for Development

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Canada

Economic Position and Plans for Development

OF those portions of the globe to which its inhabitants are now turning to obtain, through development of natural resources and expansion of economic life, reparation for the damages of war, and restoration of world-wide prosperity, none holds larger promise than Canada. It is a land of tremendous possibilities, not only for those who live there and the people of the Western Hemisphere generally, but also for the world at large, stricken in many quarters as it is and oppressed everywhere by the magnitude of burdens accumulated during the last four years.

Canada enters upon the period of readjustment to a peace basis with the consciousness of having accomplished extraordinary things during the war, not the least of which was a swift passage to that stage of economic life where the basic industry of agriculture is enlarged by intensive effort, and manufactures have advanced to an extent indicative of ability to provide beyond domestic needs. Such a result was obtained under the pressure of a demand calculated to enlist to the uttermost the skill and energy of the Dominion. With equal enthusiasm her people are turning now to the exercise of those

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qualities in their problem of holding to the benefits that have accrued to them and realizing the implications of their achievements.

There is ample justification for their belief that they have not set themselves an impossible task. Sparse as is the Canadian population just now in comparison with the extent of territory; inadequate as is their industrial organization compared with that of the United States, or Great Britain, or France, or Japan; difficult as it may be under the conditions likely to prevail for some years to come to finance the multifarious operations incident to a general and simultaneous development of agriculture, mining, manufacturing, and commerce, both domestic and foreign; the attitude of the Canadians themselves and the estimation in which they are held by the United Kingdom and the United States give assurance that their aspirations will be encouraged in a very substantial way both at home and abroad. Already there are under consideration plans by which Canada will conserve her labor supply and, by her intelligent treatment of the immigrant, foster its increase. Every effort is being made to readjust the industrial organization, which war conditions called forth, to a peace basis, without loss of time or efficiency. As for the problems of finance the Canadian banks are establishing additional branches in sections where their services are likely to be required, foreign offices are being set up to handle export and import trans-

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actions, and foreign institutions are establishing branches in Canada. Altogether there is well under way the construction of the necessary machinery for business on such a scale as Canada contemplates.

Agricultural Productions

The natural resources which it is proposed to develop are immense in extent and variety. Agriculture is, and will long continue to be, the chief industry of the country, whatever progress may be made in manufactures. It has been greatly stimulated during the war both in the direction of a diversity of crops and in the manner of their cultivation. As the labor supply diminished with the continuance of the war, intensive methods of farming became necessary. During the year 1918 there was a marked tendency toward mixed farming, which was reflected in a reduced production of wheat and oats. The estimated yield in bushels of crops for 1918 as compared with 1917 is as follows:

Crops	1917	1918
Wheat	233,742,850	189,301,350
Oats	403,009,800	380,273,500
Barley	55,057,750	77,290,240
Rye	3,857,200	8,496,700
Peas	3,026,340	3,110,100
Beans	1,274,000	3,568,380
Buckwheat	7,149,400	11,428,500
Flax	5,934,900	5,972,200
Mix Grains	16,157,080	35,730,300
Corn for husking	7,762,700	14,214,200

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CROPS	1917	1918
Potatoes	79,892,000	104,512,700
Turnips, etc. . . .	63,451,000	130,989,600
Hay and Clover .	13,684,700 (tons)	14,681,400
Fodder corn . . .	2,690,370 (tons)	4,776,000
Sugar beets . . .	117,600	180,000
Alfalfa.	262,400 (tons)	446,400

The production of crops is likely to be stimulated by the plans now being made to settle soldiers returning from Europe and war workers at home as farmers on the vast stretches of land hitherto undeveloped. A census taken at the front in 1917 showed that of 230,000 Canadian soldiers interviewed, 105,000 expressed a desire to become farmers after the war. Of these, 78,000 had had previous experience. Canada feels that the returning soldiers have a special claim upon her and that by treating them liberally in the matter of land grants she will not only meet an obligation, but also will contribute to the general prosperity, on the theory that when agriculture is prosperous the other industries will be also.

Forest Resources

The forest products of Canada rank next to those of agriculture in value of production, the total for the last year being estimated at $175,000,000. In value of forest resources Canada is surpassed only by Russia and the United States. The forest belt extends across the country a distance of nearly 4,000 miles, with an average breadth of about 700 miles,

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giving an approximate area of 2,500,000 square miles. The nominal forest area has been estimated at 1,000,000,000 acres and the actual available area of merchantable timber at 200,000,000 acres. The supply of merchantable timber is about one-fourth of the supply available in the United States. There are forty-five principal commercial woods produced. More than one-half of the standing timber of the Dominion is in British Columbia, where is the largest and most compact area of merchantable standing timber left in the world today. The area covers more than 180,000,000 acres and the amount of timber is estimated at nearly 400,000,000,000 feet. The value of forest products exported during 1918 is estimated at $65,436,204 as compared with $52,280,875 in 1917.

The manufacture of wood pulp has become an important industry, having increased more than 250 per cent. during the last ten years. The output of wood for pulp manufacture in 1908 was 482,777 cords, with a value of $2,931,653. In 1917 the output was 2,101,356 cords, and the value $18,788,333. The pulp wood resources of the country are estimated at 1,033,370,000 cords.

Metals and Minerals

Canada is well supplied with important metals and minerals and the studies which have been made during the war by the Imperial Munitions Board are expected to result in a large exploitation of them.

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The Dominion Government has appropriated $200,000 for making the experiments with lignite as a substitute for anthracite recommended by the Council for Scientific and Industrial Research, and a similar sum has been provided by Manitoba and Saskatchewan. Canada is largely dependent upon other countries for oils but an effort is now being made to develop deposits in Western Canada. The quantity and value of some of the important mineral productions during 1917 follow:

MINERAL	QUANTITY	VALUE
Cobalt	1,089,134 pounds	$1,742,614
Copper	108,860,358 pounds	29,588,254
Gold	747,366 ounces	15,449,426
Lead	32,072,269 pounds	3,571,889
Molybdinite	271,530 pounds	271,530
Nickel	84,470,970 pounds	33,778,388
Platinum	49½ ounces	5,090
Silver	22,150,680 ounces	18,034,419
Zinc	31,227,351 pounds	2,779,547
Asbestos	144,185 tons	7,215,389
Chromite	36,352 tons	490,001
Coal	14,015,588 tons	47,643,646
Graphite	3,714 tons	402,892
Gypsum	339,418 tons	887,170
Magnesite	58,090 tons	728,275
Mica	2,401,629 pounds	366,587
Natural Gas	26,465,686 cubic feet	5,003,342
Pyrilis	403,243 tons	1,586,091
Salt	138,909 tons	1,047,792
Portland Cement	4,768,488 tons	7,669,521
Lime	6,338,212 bushels	1,517,918

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The total value of Canada's mineral productions in 1917 was nearly $193,000,000. There are many minerals not included in the above compilation which are known to exist in large amount, but which have not yet been developed in commercial quantities. The output of the principal mining industries in 1918 was about the same as during 1917 because of a shortage in labor supply, but the value increased considerably, being estimated at $220,000,000. The production of coal during 1918 is estimated at 15,180,000 short tons. The estimated production of the more important metals during 1918 is estimated as follows:

> Gold, $14,750,000 in value; silver, 20,800,000 ounces; copper, 117,000,000 pounds; nickel, 91,500,000 pounds; zinc, 36,000,000 pounds; pig-iron, 1,182,000 short tons.

The Fisheries

During the war much more attention than formerly was given by the Canadians to their fisheries, because of the realization that in them the country possessed an offset to the world shortage of food. The suggestion is now made that the Government turn to them as a debt paying source, and under the direction of the Dominion Fish Committee plans are being made to exploit both the Atlantic and Pacific coasts and the lakes in Alberta, Saskatchewan, and Manitoba. There are 5,000 miles of coast-line on the Atlantic and 7,000 miles on the Pacific. The inland fisheries

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cover 200,000 square miles of fresh water, or half the fresh water area of the world. Not including the vast quantity of fish caught of which no record is kept, the value of fish marketed by Canadians in 1917 was $52,352,044, of which the sea fisheries contributed $47,052,605 and the inland fisheries, $5,299,439. Nearly 100,000 men were employed in the industry and the value of the equipment used was estimated at $33,520,748. The Council for Scientific and Industrial Research has been studying the utilization of the great quantities of fish waste. It is estimated that 300,000 tons of fish offal and non-marketable fish are annually allowed to go to waste and that the fish oil which could be obtained from this waste would be worth nearly $6,000,000 at current market prices, while other by-products would reach a value of several hundred thousand dollars more.

Railroads

There are eighty-three steam railroads in Canada with a total mileage of 51,359.74. Their capital stock is valued at $1,089,114,875 and their funded debt at $896,005,116, a total investment of $1,985,119,991. Their gross earnings, as of June 30, 1917, the latest available, were $310,771,479; operating expenses totalled $222,890,637; and net operating revenue, $89,892,502. In 1917 the number of passengers carried was 53,749,680 and the number of tons of freight, 121,916,272.

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Under the title of the Canadian Government Railways there are now operated 13,364 miles of steam railroads, the larger part of this comprising the Canadian Northern Railway, which was taken over by an Act of the Dominion Parliament last year at an award price of $10,800,000, but which is still being operated by the organization built up by those who formerly owned the road. The highly successful Canadian Pacific Railway is still privately owned and operated, but suggestions have been made that it be acquired by the Government. In this connection consideration has also been given to the possibility of bringing all the railroads under Government ownership, but with the operation in the hands either of the Canadian Northern or the Canadian Pacific organization.

The chief railroads of Canada are indexes of the extent of that country and a glance at a map will show that they still fall far short of reaching into every section of the country where commercial possibilities exist. The Canadian Northern Railway system comprises more than 9,296 miles, distributed as follows:

Nova Scotia	369.9 miles
Quebec	626.77 miles
Ontario	2,219.1 miles
Manitoba	1,989.1 miles
Saskatchewan	2,178.1 miles
Alberta	1,181.21 miles
British Columbia . . .	516.4 miles
State of Minnesota . .	215.42 miles

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The Canadian Pacific System has in operation 13,772.1 miles and in addition controls the Minneapolis, St. Paul, and Saulte Ste. Marie Railroad, with a mileage of 4,227.8, and the Duluth, South Shore, and Atlantic Railroad, with a mileage of 625.8, giving a total of 4,853.6 miles. The Grand Trunk system, exclusive of the Grand Trunk Pacific Railway, comprises 8,107 miles. It has 1,083 miles of double track, including the longest continuous stretch of double track railway under one management in the world. The Grand Trunk Pacific Railway operates 2,804 miles.

There are 2,277.9 miles of electric railway in Canada, with a total capital of $161,234,739, of which $70,606,520 is in stocks and $90,628,219 in bonds. Gross earnings as of June 30, 1917 were $30,237,663. The total income from operation was $12,431,229 and the net earnings from operation were $10,196,985.

Manufactures

Canadian manufacturing developed rapidly during the progress of the war. There was an enormous demand for all products and the building of new plants or the extension of old ones proceeded rapidly. Now the country finds itself impelled toward a continuance of this development in order to reduce the necessary importations of a new and growing country, to pay off war debts, and to provide employment for her returning soldiers or those whose services as munition

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workers are no longer required. A difficulty in the way is the necessity that basic industries shall be able to put forth diversified products. The ability to concentrate on specialized products, which permits of quantity production at low cost in more industrially advanced countries, is denied to Canada for the present. Her builders must be able, for example, to obtain at one and the same plant structural steel, boiler plates, wire nails, or any other steel product which they may require. In an undeveloped country, where communities are widely separated and where population is not congested, the general manufacturing plant is as necessary as the general store. No other kind will serve the community, and no other kind can support itself. A handicap is therefore placed upon Canadian manufactures by the very nature of the country and the sparseness of its population. To meet this condition, as to meet many others, there is foreign trade, and a great deal of attention is accordingly being given to it. Manufactures will grow with the assurance that surplus production can be marketed abroad.

The Dominion Bureau of Statistics recently completed its census of the manufactures of Canada for the year 1917. The returns cover 34,380 establishments and show how remarkable has been the development in this branch of Canadian industry since 1915. The following table sets forth these contrasts:

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	1917	1915
Capital invested	$2,772,517,680	$1,994,103,272
Employes on salaries	73,598	52,683
Salaries paid	$95,983,506	$60,308,293
Employes on wages (including piece workers)	619,473	462,200
Wages paid	$457,245,456	$229,456,210
Cost of Materials	$1,602,820,631	$802,133,862
Value of Products	$3,015,506,869	$1,407,137,140

The gross value of goods made in Canada in 1917 amounted to $3,015,506,869 and the cost of material was $1,602,820,631, leaving a net value added by the process of manufacture of $1,412,686,238, or $5,449,098 more than the gross value of production in 1915. The twenty leading industries with the gross and net values of their production are given below in order of precedence:

	Value	
	GROSS	NET
Flour and grist mill products	$224,191,735	$40,604,799
Steel furnaces and rolling mills	170,679,000	62,040,044
Slaughtering and meat packing	153,279,252	36,082,497
Log products	115,884,905	75,159,877
Munitions	112,866,838	70,240,233
Pulp and paper	96,340,324	61,627,462
Butter and cheese	85,731,339	13,710,662
Cars and car works	78,564,527	39,884,077
Bread, biscuits, and confectionery	77,223,581	33,022,111
Sugar refined	73,139,260	20,149,349
Smelting	69,262,167	33,591,253
Foundry and machine shop production	66,945,483	43,322,382

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	Value	
	Gross	Net
Iron and steel production . . .	59,797,766	26,777,534
Building and contracting. . . .	54,668,255	32,927,335
Automobiles	54,466,273	18,880,453
Slaughtering, not including meat packing	53,441,466	14,771,901
Boots and shoes	49,170,062	22,389,519
Electric light and power	44,536,848	44,536,848
Leather—tanned, curried, and finished	41,117,128	14,492,651
Electric apparatus and supplies .	40,204,245	20,046,238

The totals of the twenty leading industries in gross and net value of production were $1,720,700,960 and $724,266,227, and they represent respectively 57 per cent. and 51 per cent. of the grand totals for the Dominion.

The total capital invested in Canadian industrial plants in 1917 was $2,772,517,680, of which

(a) Land, buildings, and fixtures amounted to $998,351,070,
(b) Machinery and tools to $567,262,538,
(c) Materials on hand, stocks in process, finished products, fuel, and miscellaneous supplies to $745,546,310, and,
(d) Cash, accounts, and bills receivable to $461,357,762.

The amount of capital invested in the leading industries was:

(1) Electric light and power, $356,004,168;
(2) Pulp and paper, $186,787,405;
(3) Log products, $149,266,019;
(4) Cars and car works, $98,274,585;
(5) Steel furnaces and rolling mills, $91,894,777;
(6) Flour and grist mill products, $72,573,982;
(7) Agricultural implements, $70,493,801;

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(8) Foundry and machine shop products, $69,915,032;
(9) Car repair shops, $68,763,298;
(10) Slaughtering and meat packing, $68,145,347.

Foreign Trade

For the last four years Canada has had a favorable trade balance, due largely, of course, to her shipments of foodstuffs and munitions. In respect of the latter it may be said that Canadian steel manufactures increased 125 per cent. during the war and that whereas at the beginning of the war no Canadian manufacturer had ever made a shell, or a cartridge case, or a fuse, the country was furnishing, during the latter part of 1917, no less than 55 per cent. of all shrapnel shells and 42 per cent. of all 4.5 shells used by the British Army. From the time the Imperial Munitions Board was established as the agent for the Imperial Government in December, 1915, orders for upward of 65,000,000 shells, of a value of $937,456,826, were placed in the country. With the signing of the armistice the great exportation of munitions was stopped and also, to a large extent, that of foodstuffs. This was due to the fact that with the elimination of the submarine menace the European countries found it no longer necessary to keep immense reserves on hand to provide against some possible submarine disaster. Now, however, these countries can use up their reserves without fear, since both supplies and tonnage will be available when they are wanted. This means a temporary curtailment of the exportation of Canadian food

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products, and stores in Canada are accumulating rapidly. Exports in December, 1918, were the smallest in three years. There was also in that month an expansion of imports, so that Canada's favorable trade balance was reduced for the month to $34,000,000, against $86,000,000 in 1917, $62,000,000 in 1916, and $46,000,000 in 1915.

Exports of domestic produce and imports entered for consumption for the full twelve months of each of the past seven years, with the balance for or against Canada, are given in the following table:

YEAR	EXPORTS	IMPORTS	BALANCE
1918 . . .	$1,229,208,244	$906,670,404	+$322,537,840
1917 . . .	1,547,430,855	1,005,071,716	+542,359,139
1916 . . .	1,091,706,403	766,501,512	+325,204,891
1915 . . .	614,129,845	450,517,774	+163,612,071
1914 . . .	379,291,000	481,214,000	−101,923,000
1913 . . .	436,213,000	659,061,000	−222,848,000
1912 . . .	341,978,000	635,585,000	−293,607,000

A report of the Dominion Bureau of Statistics gives the following tabular analysis of the character and value of the exports from Canada during the year 1918 and 1917:

	1918	1917
The mine	$75,708,425	$77,389,963
The fisheries	33,577,772	28,323,877
The forest	65,436,204	52,280,875
Animal produce.	176,407,332	170,561,884
Agricultural products . . .	320,524,859	531,300,259
Manufactures	552,683,692	682,431,692
Miscellaneous	5,369,960	5,052,305
Total export, mdse. . . .	$1,229,708,244	$1,547,340,855

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The source and distribution and the values of Canadian imports and exports for the years 1918 and 1917 are shown in the following tables:

IMPORTS BY COUNTRIES	1918	1917
United Kingdom	$72,879,109	$91,136,728
Australia	6,084,963	979,018
British East Indies	17,026,095	13,311,740
British Guiana	5,088,972	8,120,098
British South Africa	1,331,842	510,765
British West Indies	8,930,109	11,117,883
Hongkong	2,343,958	1,712,920
Newfoundland	3,287,340	2,743,597
New Zealand	7,014,313	3,351,394
Other British Empire	1,371,069	1,591,579
Argentine Republic	1,726,489	1,761,799
Brazil	1,128,616	1,036,788
China	1,867,405	1,268,662
Cuba	2,034,654	1,047,062
France	3,754,761	5,715,770
Italy	642,071	855,900
Japan	13,184,893	11,100,455
Netherlands	582,507	1,130,855
United States	738,142,064	828,886,594
Other foreign countries	18,533,670	17,692,109

EXPORTS BY COUNTRIES	1918	1917
United Kingdom	$594,250,690	$873,706,892
Australia	11,169,474	8,145,426
British East Indies	2,814,378	4,131,651
British Guiana	2,216,001	2,070,809
British South Africa	9,704,215	4,881,526
British West Indies	8,352,253	6,319,644

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EXPORTS BY COUNTRIES	1918	1917
Hongkong	968,766	1,000,475
Newfoundland	10,877,766	8,723,489
New Zealand	4,605,115	4,181,290
Other British Empire	2,505,588	1,519,281
Argentine Republic	2,683,179	1,516,914
Brazil	3,825,859	1,088,269
China	2,934,663	1,471,803
Cuba	4,879,779	3,640,784
France	101,501,396	200,289,282
Italy	9,516,642	2,318,838
Japan	10,624,274	3,766,267
Netherlands	1,026,052	2,102,428
United States	433,232,149	401,479,287
Other foreign countries	12,020,005	14,986,500

A comparison of Canadian imports from and exports to the United States in the last three years follows:

	1918	1917	1916
Imports	$738,142,064	$828,886,594	$592,088,039
Exports	433,232,149	401,479,287	260,924,864
Excess of Imports	$304,909,915	$427,407,307	$331,163,175

Despite the efforts made by Canada to curtail buying from the United States during 1918 in the hope of reducing or eliminating the premium on American dollars in Canada, due to Canada's heavy purchases here and her inability to offset an unfavorable balance with the United States with favorable balances elsewhere, there was little change pro-

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portionately. Of every $100 worth of goods imported by Canada during the year, about $81 worth came from the United States, against $82 in 1917 and $77 in 1916. On the other hand the proportion of Canadian exports to the United States to total exports rose to 35 per cent. against 26 per cent. in 1917, the expansion taking place in lines such as pulp, paper, asbestos products, nickel, etc.

Shipbuilding

Canada is very proud of her war record in shipbuilding and the policy now being carried out will not only absorb many hundreds of munition workers and soldiers from Europe, but will also be of great assistance to the export business of the country. In 1914 shipbuilding in Canada was of no importance, the production for the year being only 43,346 tons. With the outbreak of the war the industry was rejuvenated and no less than 381 vessels of various types were constructed during the war. The fourteen yards of the country were kept busy at first with contracts made by the Imperial Munitions Board; later on the Department of Marine and Fisheries arranged a program of building for the Dominion Government. This provides for the construction of forty-three steel ships of a tonnage of 211,300 deadweight and forty-six wooden ships of 128,800 tons deadweight, the former costing $40,000,000 and the latter almost $25,000,000. Since the signing of the

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armistice the abandonment of the wooden ship part of the program has been under discussion. Contracts have also been made for ships for the account of Norway and France. The first vessel for Canadian Government account was launched early in December, 1918. It is hoped that before June 1 fifteen ships will have been launched and that before the end of the year 1919 at least thirty will be in the water.

Hydro-Electric Power

Because Canada has had to import so much coal to maintain her railroads and industries, attention has been more and more directed during the war years to the possibility of developing electrical energy through utilization of water power. A table prepared recently by A. M. Beale, Administration Engineer and Dominion Land Surveyor, shows the available water power of the Dominion to be 18,803,000 horsepower. There has been developed so far only 1,735,598 horse-power, which he figures is the equivalent under average conditions to an annual coal consumption of 53,213,000 short tons. This is nearly twice as great as the annual coal consumption of the Dominion.

The Dominion Bureau of Statistics recently completed a survey of central electric power stations, that is, stations developing electrical power for sale.

The capital invested in power stations totals $356,004,168, of which 79.5 per cent is invested in

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commercial stations and 20.5 per cent in municipal or public-owned stations. Total employes number 8,840, receiving wages and salaries totalling $7,777,715 per annum.

The total revenue received from the sale of electrical energy was $44,536,848, of which $29,135,399 was secured by commercial and $15,401,449 by municipal plants. The primary power installation in central stations totals 1,844,571 horse-power, of which 78.3 per cent., or 1,444,314 horse-power, is installed in commercial stations, and 21.7 per cent., or 400,257 horse-power, in municipal stations. Of the total primary horse-power installed, 1,652,661 horse-power is derived from water, 180,800 from steam, and 11,710 from gas and oil.

Of special interest is the actual cost of construction of hydro-electric power stations per installed horse-power. Omitting all real estate, transmission, and distribution equipment, seventy representative hydro-electric stations throughout the Dominion, with an aggregate turbine installation of 745,797 horse-power, and a total construction cost of $50,740,458, show an average cost of $69.11 per installed turbine horse-power.

One of the most important facts disclosed by the survey is the outstanding position which water power takes in the central station field. Out of a total installed primary capacity of 1,844,571 horse-power, 1,652,661, or 89.6 per cent.,—practically

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90 per cent.,—is derived from water. This figure is indicative of the extent and availability of the water power resources of the Dominion and of the remarkable degree to which their adaptability for central station work has been appreciated in principle and realized in practice.

Development of electric energy by water power is being urged by many Canadians not only as a means of reducing the country's enormous coal bill, but also as a labor saving measure which will enable the laborer to increase his net output. Mr. Beale says that in Great Britain a great deal of attention has been given to the subject and figures have been submitted to prove that the continuance of the upward trend of wages is dependent upon the greater per capita use of mechanical energy. He adds: "The old idea of restricted output in order to keep up prices and wages seems about to give way to the new one of stimulated output, the greater production of marketable manufactures per capita by the introduction of labor-saving devices, automatic machinery, etc., and it seems probable that labor will accept the new regime and share in the rewards of enhanced output."

Canada's Financial Record

No estimate of Canada's resources would be complete without an account of that country's remarkable accomplishments in finance, or without some indication of their bearing upon the future relations

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between Canada and the United States. Canada borrowed heavily abroad in the years before the war. E. R. Wood, president of the Dominion Securities Corporation, estimates sales of Canadian bonds for the five years 1910-1914 at $1,417.481,922, of which total Canada absorbed 14.35 per cent., the United States 10.50 per cent., and Great Britain 75.10 per cent. He places the total sales for the war years, 1915-1918, at $2,207,140,715, of which Canada absorbed 61.74 per cent., the United States, 34.06 per cent., and Great Britain, 4.20 per cent. The entrance of the United States into the war threw Canada upon her own financial resources entirely and the manner in which her people accepted the added burden is shown by the fact that the amounts of her war loans and the number of subscribers increased steadily.

In November, 1915, the Government asked for $50,000,000. The amount subscribed was $113,729,-500 and the number of subscribers was 24,862. In September, 1916, the amount asked for was $100,-000,000. Including conversions, the total subscription was $195,371,000, and the number of subscribers, 34,526. In March, 1917, a loan of $150,000,000 was asked for, and, including conversions, a subscription of $236,654,000 was registered, while the number of subscribers went up to 41,000. Another $150,000,000 was asked for in November, 1917. This loan was offered at par with an interest bonus on the first coupon, the rate being 5½ per cent. The subscrip-

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tions totalled $419,289,000 and the number of subscribers, increased to 820,035. The amount allotted on these four issues, not including conversions in the second and third loans, was $764,187,800; the average subscription was $4,128; and the subscription per capita rose from $14 in the first loan to $52 in the loan of November, 1917.

The Canadian Victory Loan of November, 1918, begun five days after the signing of the armistice, eclipsed all previous records. The amount asked for was $300,000,000. While the results have not been fully tabulated a statement compiled in January shows a total subscription of $695,389,227. One person in every seven subscribed and the average per capita subscription for the Dominion as a whole was $88.91. The number of subscribers was well over 1,064,000.

To float this loan it was necessary to take from past as well as current savings. Savings deposits in the Canadian chartered banks dropped from $1,076,000,000 in October, the highest level ever reached in Canadian banking, to $939,000,000 in November, but by the end of January they were up to $990,000,000, a recovery of $19,000,000 in December having been followed by one of $31,000,000 in January. Adding to savings deposits the deposits subject to withdrawal on demand, the total to the credit of the Canadian people on February 1 was $1,613,000,000, as compared with $1,720,000,000

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just prior to the last loan. These figures are the more astonishing, considering that the working population of the Dominion, estimated at 8,075,000 in 1914, was decreased by a very large overseas army, when the fact is disclosed that the banks of the country did not take the loan. During the war period the banks subscribed to a total of only $50,000,000 and these bonds were sold to the public in the course of a few months. With such a record Canada faces the future without any fear. Her war debts will be paid quickly, and while interest charges, pensions, and huge sums for reconstruction work and development of her resources will entail heavy burdens upon her, the number of her workers is expected to increase rapidly and there is no voice of pessimism raised within her borders.

America's Interest in Canada

What has been the part hitherto played by the United States in Canada's development, and what is it likely to be in the future? In spite of the fact that the United States in the past has been chiefly pre-occupied with its own internal development, she has contributed a fair share toward Canada's economic expansion. While Great Britain has been largely responsible for the extension of the Canadian railroad system, the United States played the greatest part in Canada's industrial development. It was United States capital that developed the water power

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and industries around Sault Ste. Marie. The coal industry of Nova Scotia and the great steel works of Sydney have been built through American enterprise. American promoters have obtained franchises to develop the Canadian side of the Niagara Falls. It was American effort that accomplished the greater part of the development of the Klondike. Half of the great mining industry of British Columbia may be said to belong to United States capital. Two of Canada's leading industries—timber and lumber—are considered to be pre-eminently the development of United States capital. A considerable number of agricultural plants and warehouses have been established by American capital throughout the agricultural areas of Canada. Generally it may be said that as investors the people of the United States have had a great deal to do with the remarkable development of natural resources, agricultural production and production of minerals which has taken place in Canada.

Mr. H. P. Willis, formerly secretary of the Federal Reserve Board, is authority for the statement that the total American investments in Canada prior to the war amounted to more than $600,000,000. The war greatly stimulated American investments in Canada which, according to the best estimates, have nearly doubled during the last four years, reaching the prodigious sum of $1,272,850,000, and distributed as follows:

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500 branch firms (average investment $300,000)	$150,000,000
Government, municipal, and corporation bonds (1905-13)	123,743,000
Government, municipal, and corporation bonds (1913-17)	590,506,000
Insurance company investments	94,276,000
British Columbia mills and timber	75,000,000
British Columbia mines	62,000,000
British Columbia Land transactions	60,000,000
Prairie provinces land transactions	41,000,000
City and town properties	20,000,000
Maritime provinces investments	13,125,000
Industrial investments, miscellaneous	12,200,000
Prairie provinces lumber and mines.	10,500,000
Agricultural implement firms	9,250,000
Packing plants.	6,750,000
Theatrical enterprises	3,500,000
Fox Farms (Prince Edward Island).	1,000,000
	$1,272,850,000

There are five hundred branch firms of American industries located in Canada. These branches are usually well provided with working capital and will undoubtedly continue to contribute much to the development and strengthening of industry in Canada.

One of the most effective ways in which the United States has contributed to the economic development of Canada has been through the movement to western and northwestern Canada of agricultural settlers who have been very influential in the development of the great wheat growing section of the Dominion. During the fifteen years before the war the total

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number of persons entering Canada from the United States was 1,014,000, while the number of people entering the United States from Canada was 431,000, indicating a net gain to Canada of 583,000 immigrants. Besides being an economic asset to the country as producers of wealth, these immigrants brought with them a considerable amount of wealth, amounting to $192 per immigrant, or a total of $195,000,000 for this fifteen-year period.

Canada's Investments in the United States

United States investment in Canada brought as a natural consequence some Canadian investment in the United States; but this never grew to any great proportions, as Canadian capital was lured away from foreign fields by the attractive opportunities naturally offered by a country so young and undeveloped. For the most part, Canadians showed interest in private corporation holdings, as, for instance, United States Steel Corporation stock, of which the total Canadian holdings in 1914 were $7,892,000. It seems hardly likely that there has been any marked accumulation of American securities in Canada of late, for the need of conserving capital in that country has compelled the Minister of Finance to discourage foreign investment.

After the declaration of war by the United States, and the Government's entrance upon a policy to conserve capital for war purposes, it was not so easy

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for other countries to borrow in our open market. This naturally had its bearing on the financial situation in Canada and it seemed as if the United States market was practically closed to Canadian offerings. It appears, however, that the United States Government had placed contracts amounting to $125,000,000 with Canadian munition concerns, and that Great Britain has utilized $400,000,000 of the credit advanced by the United States Government to Great Britain since April, 1917, for the payment of goods that Great Britain has purchased from Canada.

It will be seen that these sums have practically approximated the annual borrowings of Canada from other countries, except for the abnormal year 1917.

Increase in Financial Relations

As has been indicated, the increase in financial relations between Canada and the United States has been an outgrowth of conditions concomitant with the war, and the question may be raised whether in the future there will be a tendency for these financial relations to become permanent. In this connection there are certain considerations which would indicate that after the declaration of peace the financial relations between the two countries should become more important than they were before the outbreak of the present war.

As has been pointed out, one of the important factors in the relations between Canada and the

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United States has been the movement of peoples between the two countries. Such movements always tend to bring nations closer together in trade and financial relationship. One of the important economic results of the present world war will probably be an increase in the movement of peoples between countries, and it is not unlikely that the great Canadian northwest will be further developed by the sturdy men of our great Middle West who have had their spirit of adventure quickened, and naturally the opportunities of this region will make an appeal to them.

The Spirit of Adventure

In 1914 the combination of economic forces of the world was preparing for the development of new areas. With the world war quickening the spirit of adventure in man and tending to break down the barriers that had tended to prevent the free movement of peoples between countries, and with the pressure to increase the world's supply of foodstuffs and raw materials, it is probable that in the long term swing, after the declaration of peace, the undeveloped areas of the world will experience a development the magnitude of which we are not able today to gauge. Canada, with her abundance of raw materials, her large forest wealth, her large areas of agricultural land awaiting development, will undoubtedly attract men and capital.

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The last quarter of a century has seen a gradual change in the economic life of the United States. Previously we had been in the position of a new country with a frontier constantly being developed and expanded, which was absorbing people and capital of various countries of the world. We have largely developed this frontier area and have built up an industrial capacity to such an extent that before the outbreak of the war we were reaching the point where as a nation there would be surplus funds available for investment. During the European war the industrial capacity of the country has been materially increased, and the United States as a country is in a position to be a lender of capital to other countries. Because we know Canada better than perhaps any other country, and because of the Dominion's great opportunities, our country ought to play a part in the development of the natural resources of Canada which will be beneficial to the industry and enterprise of both countries.

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Federal Stamp Ta
Drafts, Check
and Promissory N

1919

Guaranty Trust Co
of New York

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Federal Stamp Taxes on Drafts, Checks and Promissory Notes

Imposed by
Title XI of the Revenue Act of 1918

1919

Guaranty Trust Company of New York
140 Broadway

FIFTH AVENUE OFFICE Fifth Avenue and 43rd Street	LONDON OFFICE 32 Lombard St., E. C.	PARIS OFFICE Rue des Italiens, 1 & 3
MADISON AVENUE OFFICE Madison Avenue and 60th Street	LIVERPOOL OFFICE 27 Exchange Buildings	BRUSSELS OFFICE 15 8 Rue Royale

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Stamp Taxes on Drafts, Checks and Promissory Notes*

THE Revenue Act of 1918 imposes a tax on drafts and checks, payable otherwise than at sight or on demand, upon their acceptance or delivery, whichever is prior, within the territorial jurisdiction of the United States, and on promissory notes, except those listed below as exempt, and on each renewal of the same. The term "United States" includes the states, the District of Columbia, Hawaii and Alaska.

The tax is at the rate of 2 cents on each $100 or fractional part thereof. On amounts not in excess of $100 the tax is 2 cents.

Any instrument or writing operating as a renewal of a promissory note is taxable, but the mere suspension of payment or forbearance does not constitute a taxable renewal within the meaning of the law, nor does payment of interest on a demand note, without any agreement in writing extending the note.

*Based on Treasury Regulations No. 55.

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The payment, however, of interest in advance, after maturity of a promissory note, evidenced by an indorsement, constitutes a taxable renewal.

Liability to tax and the amount thereof, is determined by the form and face of a check or draft and cannot be affected by proof of facts or instructions outside of the instrument. Payment for the stamp is a matter for adjustment between the parties, but obligation rests upon the drawee, payee, or indorsee of a draft to see that the tax is paid before or at the time of acceptance or delivery and both parties to a promissory note are responsible for affixing and cancelling stamps in the required amount.

Checks and Drafts

The following instruments payable otherwise than at sight or on demand are included among taxable drafts and checks:

1. Trade and bankers' acceptances.
2. Post-dated checks expressly payable after their date.
3. Time drafts drawn against the proceeds of drafts exempt under (4) below.

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4. Drafts stating no time for payment which are accepted for payment at a certain future date.
5. Time drafts drawn on a domestic bank for the purpose of securing money to purchase goods to be exported.
6. Time drafts, not covering exports, drawn and delivered or accepted in the United States and payable in foreign countries.
7. Time drafts covering articles shipped from the United States, Hawaii and Alaska to the Canal Zone, if such drafts are delivered within the United States, Hawaii or Alaska.
8. Time drafts drawn against shipments from the Virgin Islands, the Philippines and Porto Rico into the United States, if delivery or acceptance of such drafts first takes place within the United States, Alaska or Hawaii.

The following checks and drafts are exempt from tax:

1. Demand checks.
2. Post-dated checks not expressly payable after their date.
3. Time drafts covering shipments to the Virgin Islands, the Philippines and Porto Rico.
4. Time drafts directly covering exports to a foreign country, and constituting an inherent, necessary and bona fide part of the actual process of exportation.
5. Time drafts drawn on domestic banks against export shipments delivered to the first carrier for transportation, covering the period of transit from the interior point to the seaboard.

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6. Drafts drawn abroad on a foreign drawee with a foreign payee, passing through a bank in the United States in the course of collection unless delivered by an agent of the drawer to an agent of the payee within the United States.

Promissory Notes

The following promissory notes and renewals of the same are included among instruments taxable:

1. Notes given for security only.
2. Notes payable on demand or after date.
3. Promissory notes accompanying mortgages of joint-stock land banks.
4. Promissory notes secured by bonds of the War Finance Corporation.
5. Promissory notes executed and mailed in the United States to a payee in Canada.
6. Extensions or renewals of promissory notes brought about by extension of mortgages by which such notes are secured.
7. Instruments in the form of promissory notes, representing the interest upon promissory notes, not included under (6) below, and either separate from or prepared in a form and for the purpose of being separated from the principal note.
8. Policy loan and premium extension agreements containing an unqualified promise to pay a specified sum of money at a certain date, except where the sole remedy of the payee in case

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of non-payment of the premiums or loans is to reduce or cancel the rights of the insured.

The following instruments are exempt:

1. Certificates of deposit.
2. Bank notes issued for circulation.
3. Promissory notes executed and mailed in Canada to a payee within the United States.
4. Promissory notes issued directly by foreign governments and placed in this country for sale.
5. Promissory notes secured by certificates of indebtedness issued by the Director General of Railroads.
6. Coupons and interest notes which are attached to a principal obligation and are substantially repetitions of the promise to pay interest contained in the principal obligation.
7. Promissory notes secured by United States bonds or obligations issued after April 24, 1917 or secured by the pledge of a promissory note which itself is secured by the pledge of such bonds or obligations. Such bonds must have a par value of not less than the amount of such notes to exempt the latter.

Cancellation of Stamps

Any person using or affixing stamps must so deface the same as to render them unfit for further use by writing or stamping his initials and the date thereon with ink, or by

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cutting and canceling such stamp with a machine or punch, which will affix the initials and date. The cancellation should not so deface the stamp as to prevent its denomination and genuineness from being readily determined.

In addition to the above, stamps of the value of 10 cents or more must have three parallel incisions made by some sharp instrument lengthwise through the stamp after the same has been attached to the document, except where the stamps are cancelled by perforation.

Use of Cancelled Stamps—Refunds

A stamp affixed to an instrument and cancelled cannot lawfully be removed and attached to another instrument. Refund will be made by the collector of internal revenue for amounts paid for stamps used in excess of requirements, or on instruments not actually effective and for which a substitute is prepared and stamped, or on instruments not subject to tax.

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Foreign Financing

Under the Edge Act

Guaranty Trust Company
of New York

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Foreign Financing

Under the Edge Act

Approved December 24, 1919

Guaranty Trust Company of New York
140 Broadway

FIFTH AVENUE OFFICE
Fifth Avenue and 43rd Street

MADISON AVENUE OFFICE
Madison Avenue and 60th Street

LONDON OFFICE
32 Lombard Street, E. C.

LIVERPOOL OFFICE
27 Cotton Exchange Buildings

PARIS OFFICE
1 and 3 Rue des Italiens

HAVRE OFFICE
122 Boulevard Strasbourg

BRUSSELS OFFICE
158 Rue Royale

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Aug 15, 1924

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Guaranty Trust Company of New York

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Foreign Financing

under

The Edge Act

OUR merchant marine and our foreign trade, both of which were built up and maintained during the war at so great a cost, are threatened by new conditions which may not only hinder their further development, but even challenge their achieved position. The principal dangers are the foreign exchange situation, and the inability of most American sellers and banking institutions to grant long-term credits to European purchasers of our raw materials, machinery and manufactured articles. Since the termination of the Great War, the future of our international trade has been uncertain, and close students of the financial and economic situation prevailing in European countries have viewed with great concern the decrease in our export trade.

During the past six months of 1919, an acutely serious situation has arisen by reason of the sharp break in European exchanges. The French franc, the

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Italian lire, and the German mark have all dropped far below par and even the pound sterling has fallen though not to the extent of the others. The result has been to increase greatly the already high cost of American goods to purchasers in Europe, as the merchant or manufacturer buying American dollars to pay for the goods has been forced to pay much more than a dollar, depending on the percentage of decrease in the value of the European money used in the purchase. Accordingly, the cost of American goods has become almost prohibitive and as a natural consequence, if this condition continues, we shall find that the demand for our goods will become less and our export trade will be seriously impaired. Production must be stimulated if we are to compete with other countries and keep our industries going, and a foreign market must be maintained for the disposition of our surplus raw materials and manufactures on a basis which makes it attractive for the foreigner to buy our goods. Otherwise, before long we may find ourselves being outstripped by England and Germany, our greatest rivals before the war.

Foreign Financing under Federal Control

With the object of remedying the foreign exchange situation, extending quick credits to European purchasers and thus increasing the demand for our goods,

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stimulating our foreign trade and further developing our new merchant marine, Congress, during the past year, has enacted two laws, the McLean Act and the Edge Act, supplementing existing legislation. Even as far back as 1913, steps were taken to procure for us a larger participation in foreign trade and commerce when the Federal Reserve Act was enacted providing, among other things, that any national banking association having a capital and surplus of at least $1,000,000 might, upon securing the approval of the Federal Reserve Board, establish branches in foreign countries and dependencies of the United States. Prior to that time, the financing of our foreign trade was done mostly by the great English banking houses and by a few strong private banking establishments of New York which had foreign branches in Europe. The small independent banks of the country could only help to a very limited extent.

The Federal Reserve Act, however, gave our national banks an opportunity to compete on nearly even terms, but few felt disposed to risk their capital in foreign branches, and the need of further legislation was clearly indicated. In 1916 further steps were taken in this direction and a law amending Section 25 of the Federal Reserve Act, enacted on September 7, of that year, permitted national banks having a capital and surplus of at least $1,000,000 to co-operate in the establishment or ownership of American banks or corporations principally engaged in foreign banking, by investing

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amounts not to exceed 10 per centum of their capital and surplus in such institutions "chartered or incorporated under the laws of the United States or of any State thereof." Certain banking institutions have organized banking corporations of the kind contemplated by the 1916 amendment, for the purpose of financing American exporters and importers, but from some sources, it is stated, appeals have been made for Federal incorporation.

The arguments urged in favor of the enactment of such a law are that the time will probably come when the conflict of the dual control exercised by the Federal Reserve Board and by the banking departments of the states may be a matter of embarrassment, or may operate to restrict the activities of the banking corporation, and that such a banking corporation being essentially a national enterprise, the ownership of whose stock by national banks was authorized by an Act of Congress, should be entitled to the benefits and protection of a Federal charter which would prove of great value in competing for business in foreign countries. A Federal incorporation act substantially similar to the Edge Act, was later proposed by the Federal Reserve Board and passed the Senate, but the bill never passed the House.

On September 17, 1919, the McLean Bill became a law, under the provisions of which national banks, without regard to the amount of their capital and surplus, are permitted to subscribe in amounts not in excess of

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5 per centum of their capital and surplus to the capital of corporations of the kind contemplated by the Edge Act, thus enabling national banks to further contribute to the financing of our foreign trade.

Purpose and Effect of Edge Act

The Edge Act, which has been strongly indorsed by the Federal Reserve Board, was introduced in the United States Senate on July 15, 1919, and became a law upon being signed by the President on December 24, 1919. With the enactment of this law, supplementing the amendment of September 7, 1916, and the McLean Act, it is hoped that much of our great foreign trade can be retained to the benefit of American manufacturers and producers. The Act provides for the Federal incorporation and regulation of banking institutions for the purpose of engaging in international or foreign banking, or other foreign financial operations or for engaging in such operations in a dependency or insular possession of the United States, either directly or through the agency, ownership or control of local institutions in such places.

Two distinct classes of corporations are contemplated, although the line of demarcation between them may not always be closely drawn—one class doing principally a banking business, the other an investment business, taking long-time paper, including bonds and mortgages and issuing their own debentures against them. The class of corporations carrying on a banking

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business may conduct nearly every kind of financial operation, but may not receive deposits in the United States except such as may be incidental to or for the purpose of carrying out transactions abroad. Both classes of corporations are prohibited from carrying on any part of their business activities in the United States except such as in the opinion of the Federal Reserve Board may be incidental to their foreign or international business. They may not become members of the Federal Reserve System and are not authorized to invest in any corporation, other than a banking corporation, an amount in excess of 10 per centum of their own capital and surplus, without the approval of the Federal Reserve Board.

The practicability of financing our export trade through the organization of such corporations as are contemplated by the Edge Act, is clearly expressed by the following statement of Senator Edge:

"The procedure under the prospective law is simplicity itself; it is merely the application to international trade of the accepted method by which John Doe sells his business to penniless Richard Roe and yet obtains actual cash payment in the transaction. The American exporter or manufacturer may sell his goods to an impoverished foreign purchaser—a foreign government or a private concern. One of the proposed corporations then may accept collateral from the purchaser, acceptable to the Federal Reserve Board, and against this issue debentures to sell to investors, and the money so

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received will be paid to the American seller. Through the powers granted to these proposed corporations they may accept even mortgages on the plants or other real property of the purchasers * * *. Thus a foreign concern in need of raw material may obtain it by giving a mortgage on its plant, and eventually by turning this raw material into finished product will be able to redeem its collateral and to put aside a little profit besides."

Senator Owen in advocating the passage of the bill in the Senate paid tribute to the part played by the Guaranty Trust Company of New York and other New York banks in building up our foreign trade, but stated that such institutions were carrying as large an amount of foreign credit instruments as they could afford to carry, and that unless the mechanism were provided by which these foreign credits could be sold to the American investor there was no way available, on the vast scale required, to rehabilitate Europe by restoring the raw materials and machinery required to place it on the highly productive basis it occupied before the War. At the present time there are fairly adequate facilities for the granting of thirty, sixty, or ninety day credits to European purchasers, and some member banks of the Federal Reserve System, of which the Guaranty Trust Company of New York is one, are effectively participating in such short-term financing.

The granting of long-term credits, however, for pe-

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riods beyond ninety days, which are much needed by the European purchaser of our goods, offers a far more serious situation and present facilities are admittedly inadequate. Let us suppose, for instance, that a corporation whose properties are in the devastated section of France desires to buy American machinery to start rebuilt factories in operation, and that it desires to buy on credit, giving as security for the purchase price, only corporate bonds which mature eight or ten years hence. Even though satisfied as to the safety of the security offered as collateral for the extension of the credit, the American manufacturer is in most cases unable to carry it until maturity because this would tie up and deprive him, for many years, of the use of the capital which he requires in his business. Therefore, the seller is compelled to lose the sale unless the bonds can be quickly converted into cash. It is possible here to relieve the situation by an arrangement made with a corporation organized under the Edge Act to take such foreign securities, advance the cash, and within such limitations as the law and the Federal Reserve Board prescribe, issue its own notes which could then be offered to the public for investment. By this method the purchaser at once receives the purchase price, and the European buyer obtains the goods. The credit is successfully passed to the American investor.

There are many institutions abroad operated upon a similar plan that specialize in financing foreign trade by the acquisition, disposition and rehypothecation of

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securities. Until the passage of the Edge Act, there was no Federal statute that provided for the organization of such corporations, and before the passage of the McLean Act, national banks having a capital and surplus of less than $1,000,000 were not authorized to invest in corporations of the kind now contemplated by the Edge Act.

The value of the Edge Act lies in this, namely, that it provides for the organization of corporations having the right to engage in international and foreign banking, in which national banks may participate to a limited degree, thereby affording a means to make available quick and large capital for the purpose of extending credit to Europe. In short, the Act provides a sound, well-regulated system of financing our foreign trade whereby such collateral as foreign purchasers possess may be taken in payment of American goods. The new opportunities of the Edge Act, however, should not be overestimated, as corporations organized under state laws have been financing foreign trade in substantially the same manner as therein provided, the Edge Act merely adding as additional inducement, the prestige which Federal incorporation and Federal regulation offer.

Mr. Gilbert H. Montague, a reputed legal authority who has specialized on industrial combinations formed for export trade, in a recent analysis of the provisions of the Edge Bill, said:

"The problem is very similar to that of an American

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street railway, which needs electrical equipment, and can pay for it only with its corporate bonds maturing ten years hence. For many years, various electrical equipment manufacturers have maintained subsidiary companies which, in instances like these, have taken street railway bonds, and deposited them, together with other bonds accepted from other customers in purchase of electrical equipment, with a trust company, under a trust agreement to secure an issue of the subsidiaries' own notes, which the subsidiaries have then sold to institutions and individuals for permanent investment. The money which the investing public has thus paid to the subsidiaries, in exchange for the latter's notes, has, in effect, returned through the subsidiaries to the electrical manufacturers to pay them for the electrical equipment which they have sold to the street railway. Thus, the street railway has bought on long-time credit, but this long-time credit has been carried by the investing public, and not by the electrical manufacturers or their banks.

"Instead of themselves organizing subsidiary companies to finance sales to their foreign customers, American manufacturers, in some instances, may best be served by leaving this work to be done by their banks, collectively and cooperatively. One hundred million dollars of purchases by the French Government from American manufacturers during the European war, were thus successfully financed, and eventually fully paid for, by a credit operation which has now become history.

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"On July 14, 1916, the American Foreign Securities Company was incorporated in Delaware, by a group of American bankers, to acquire, by purchase or otherwise, and to hold or dispose of stock, bonds or obligations of any foreign or domestic government or corporation. On July 18, 1916, the Company entered into a contract with the Government of the French Republic, whereby the Company made the French Republic a loan of one hundred million dollars, bearing interest from August 1, 1916, and payable July 31, 1919. Unlike the examples already considered, the Company not only took the note of the French Government but also insisted that the French Government deposit collateral with the note. To secure the payment of principal and interest of the loan, the French Republic pledged various securities with the Company and authorized the Company to rehypothecate these securities. The value of these securities was calculated to be one hundred and twenty million dollars, and the French Government agreed to pledge from time to time additional securities so that the calculated value of the collateral should always be twenty per cent. in excess of the principal of the loan. The collateral pledge included obligations of the Governments of Argentina, Sweden, Norway, Denmark, Switzerland, Holland, Uruguay, Egypt, Brazil, Spain, Province of Quebec, Suez Canal, and various United States and Canadian corporations. Under its authority to rehypothecate these securities, the Company deposited $126,526,534 worth of them with 'a financial institu-

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tion' in New York, as trustee, under a trust agreement to secure $94,500,000 of the Company's three year, 5% gold notes, dated August 1, 1916 and payable August 1, 1919, which notes the Company publicly offered for general sale in July, 1916 at 98 and interest. Throughout the war, these notes maintained a high value, and on August 1, 1919 they were paid in full. Meanwhile, the Company paid dividends averaging more than eight per cent. per annum upon its $10,000,000 of capital stock.

"Instead of individually organizing subsidiary companies like the electrical equipment manufacturers above described, or of leaving this work to be done by their banks, upon the analogy of the American Foreign Securities Company above described, American manufacturers in the same line of business may, in some instances, best finance their sales to foreign customers by collectively and cooperatively organizing and operating their own investment and financial corporation for that purpose. Such an institution, with a capitalization of upwards of one hundred million dollars, is already under consideration, according to newspaper reports, by a group of American manufacturers of railway equipment who, it is stated, will themselves take the leadership in the institution, and will depend for expert financial and banking assistance and for the marketing of their securities when issued upon their affiliated banking connections and upon security-issuing houses associated with them in the enterprise.

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"European bankers, somewhat more than American bankers, have more or less permanently invested their own funds in long-time credits, and have thus assimilated the standpoints of both the manufacturer and the banker which, excepting possibly in the public utility field and the electrical equipment field, and more recently in a few instances in the foreign field, have not often been combined in the United States. Danger is always possible, of course, in any departure from the banker's strict standards of credit. Inertia, however, is no less possible in the inelastic application to long-time credits of standards to which bankers are accustomed in the short-time credits which constitute their business. In the future financing of the American export trade, neither the banker's standpoint nor the manufacturer's standpoint can be disregarded. The most fortunate results, it is believed, will be obtained by a policy which fairly reflects both points of view.

"How successful may be investment in financial institutions which have attained this golden mean appears from the history of some of the English, Scotch and Swiss 'investment trusts.' These are institutions for the acquisition, disposition and rehypothecation of securities particularly in foreign trade and are operated substantially upon the plan of the electrical equipment subsidiaries above described, and began to be formed in Great Britain during the third quarter of the last century. Like our own American life and fire insurance

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companies, these investment trusts have pursued the policy of selecting their securities in various lines of trade and from all parts of the world. The Investment Trust Corporation, Ltd., of London, for example, in its statement for 1917, shows 315 kinds of investments; the Second Edinburgh Investment Trust, Ltd., of Edinburgh, Scotland, for the same year, showed 235, and the Metropolitan Trust Company, of London, showed 220. These investments included foreign government issues, municipal loans, mortgage bonds, preferred and common shares in railroads, public utilities, banking, commercial and industrial corporations. The Investment Trust Company, Ltd., of London, is capitalized for $10,000,000 and has outstanding $10,000,000 in 4 per cent. bonds, and during the ten years expiring in 1917 paid dividends averaging about 12 per cent. per annum upon its common stock. The Second Edinburgh Investment Trust, Ltd., of Edinburgh, Scotland, is capitalized for $2,250,000 and has outstanding $1,950,000 in 4 per cent. bonds and during the nine years expiring 1916 paid dividends averaging 12 per cent. per annum upon its common stock. The Metropolitan Trust Company, Ltd., of London, is capitalized for $4,000,000 in 4 per cent. bonds and during the ten years expiring 1918 paid an average of 12 per cent. per annum upon its common stock. The Bank for Electrical Securities of Zurich, Switzerland, which specializes in the securities of public utility companies, and the Franco-Swiss Company of Geneva, Switzerland, which special-

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izes in city and railroad bonds, have had almost as great a development."

Financial corporations of the kind contemplated by the Edge Act have already been organized, with very broad powers, under the statutes of the several States. Among these institutions may be mentioned the Asia Banking Corporation, the Mercantile Bank of the Americas, Inc., the Foreign Discount Corporation, etc. Some of these corporations are now partially under the control of the Federal Reserve Board where national banks contribute to their capital, since they are required to restrict their operations and conduct their business in such manner and under such limitations as the Federal Reserve Board may prescribe. It was felt, however, that control through agreement is not as satisfactory as that exercised through incorporation under a Federal act.

The enactment of the Edge Act should prove of especial value to corporations that have combined under the Webb-Pomerene Act for the purpose of carrying on an export business, since in effect, it affords a practical method under Federal supervision, whereby industrial or producing combinations may extend large credits abroad. A group of manufacturers, for instance, who have formed a combination under the Webb-Pomerene Act to sell their products abroad may now combine to finance such sales and thus, in the language of Senator Edge, "will be able to keep all the reins in their own hands."

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Mr. W. P. G. Harding, Governor of the Federal Reserve Board, in urging the passage of the measure, made the following statement: "The Board knows no one way in which the present European credit situation may be more effectively dealt with than by the incorporation of institutions of the kinds provided for in this bill, and anything that betters that situation assists not merely in the gigantic task of reconstruction in Europe, but also in providing a market for our own exports and in developing our foreign commerce in a most effective and satisfactory way."

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Synopsis of the Edge Act

Organization of Corporations

THE statute provides that any number of persons, not less than five, may form a corporation of the kind authorized by the law, the life of which shall be twenty years, unless sooner dissolved by act of the shareholders owning two-thirds of the stock, or by an act of Congress, or unless its franchises become forfeited by violation of law. A corporation by a vote of the shareholders owning two-thirds of the stock, may, at any time within two years prior to the date of the expiration of its corporate existence, apply to the Federal Reserve Board for an extension thereof for a period not exceeding twenty years and upon approval by the latter, the corporate existence shall be so extended unless sooner terminated in one of the ways above explained. A corporation may go into voluntary liquidiation by a vote of the stockholders owning two-thirds of the stock.

Persons desiring to enter into articles of association must specify in general terms, the objects for which it is formed, which articles may contain any provisions not

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inconsistent with law that the association may choose to adopt for the regulation and conduct of its business. The details regarding the drawing up of such articles are prescribed by the law which requires, among other things, that the name assumed by the corporation be approved by the Federal Reserve Board.

Capital Stock and Dividends

A capital stock of at least $2,000,000 is required for incorporation under the law, one-fourth of which must be paid in before the corporation is authorized to begin business, and the remainder in bi-monthly installments of at least 10 per centum on the whole amount to which the corporation shall be limited. The capital stock may be increased at any time, with the approval of the Federal Reserve Board, by a vote of two-thirds of the shareholders, or by unanimous consent in writing of the shareholders without a meeting. Any such increase must be fully paid in within ninety days after approval by the Federal Reserve Board. A corporation may reduce its capital stock in a like manner, but not below $2,000,000, and is prohibited, during the time its operations continue, from withdrawing or from permitting to be withdrawn, any part of its capital in the form of dividends or otherwise. The directors may semi-annually declare a dividend, but before the declaration thereof, one-tenth of the net proceeds of the

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preceding half year must be carried to the surplus fund until it amounts to 20 per centum of the capital stock.

A majority of the shares of stock must at all times, be held and owned by (a) citizens of the United States; (b) corporations, the controlling interest in which is owned by citizens of the United States, chartered under Federal or state laws; or (c) firms or companies, the controlling interest in which is owned by citizens of the United States.

Purchase of Stock by National Banks

Any national banking association may invest in the stock of such corporations. The aggregate amount of stock held, however, in all corporations engaged in a business of the kind contemplated by the law and by Section 25 of the Federal Reserve Act, as amended, authorizing national banking associations to establish branches in foreign countries, dependencies or insular possessions of the United States for the furtherance of the foreign commerce of the United States, may not exceed 10 per centum of the subscribing bank's capital and surplus.

Directors

All directors are required to be citizens of the United States. A member of the Federal Reserve Board is pro-

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hibited from being an officer or director of any such corporation, or of any corporation engaged in similar business organized under state laws, and he may not hold stock in any such corporation.

The provisions of Section 8 of the Act, approved October 15, 1914, as amended, known as the Clayton Anti-Trust Act, prohibiting interlocking directorates, are made applicable to the directors, other officers, agents or employees, of corporations organized under the law. A director or other officer, agent or employee, of any member bank, however, is not prohibited from serving at the same time in any corporation organized under the law in whose capital stock such member bank shall have invested, where such person serves with approval of the Federal Reserve Board. The law, likewise, does not prohibit any director or other officer, agent or employee, of any corporation organized thereunder who has procured the approval of the Federal Reserve Board from serving at the same time in any other corporation in whose capital stock it has invested.

Liability of Stockholders, Officers and Directors

Shareholders in any corporation organized under the provisions of the law are liable for the amount of their

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unpaid stock subscriptions. Where it is adjudged that any such corporation has been guilty of noncompliance with or violation of the law, each director and officer who participated in or assented to the illegal acts is made liable in his personal or individual capacity for all damages the corporation sustains thereby; and dissolution of the corporation will not impair any remedy against the corporation, its stockholders or officers for any liability or penalty previously incurred.

General Powers

In addition to the general administrative powers incidental to organization, corporations, under regulations prescribed by the Federal Reserve Board, are granted general banking powers, as follows:

(1) To purchase, sell, discount and negotiate with or without their endorsement or guaranty, notes, drafts, checks, bills of exchange, acceptances, including bankers' acceptances, cable transfers and other evidences of indebtedness;

(2) To purchase and sell, with or without their endorsement or guaranty, securities, including the obligations of the United States or any state thereof, but not including shares of stock, except as hereafter explained in the paragraph entitled "Power to Purchase and Hold Stock;"

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(3) To accept bills or drafts drawn upon them subject to such limitations and restrictions as the Federal Reserve Board may impose;

(4) To issue letters of credit;

(5) To purchase and sell coin, bullion and exchange;

(6) To borrow and lend money;

(7) To issue debentures, bonds and promissory notes under such general conditions as to security and under such limitations as the Federal Reserve Board may prescribe, but in no event having liabilities outstanding thereon at any one time exceeding ten times the capital stock and surplus of the issuing corporation;

(8) To receive deposits outside of the United States and only such deposits within the United States as may be incidental to, or for the purpose of carrying out transactions in foreign countries or dependencies or insular possessions of the United States; but a corporation receiving authorized deposits in the United States must carry reserves in such amounts as the Federal Reserve Board may prescribe, in no event less than 10 per centum of its deposits;

(9) To exercise such powers in general as are incidental to those conferred by the law, or such as in the opinion of the Federal Reserve Board,

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may be usual in connection with the transaction of the business of banking or other financial operations in the countries, colonies, dependencies or possessions in which they are transacting business and which are not inconsistent with the powers specifically granted by the law.

None of the powers conferred are to be construed as prohibiting the Federal Reserve Board, under its power to prescribe rules and regulations, from limiting the aggregate amount of liabilities of any or all classes incurred by any such corporation and outstanding at any one time.

Establishment of Agencies and Branches

Corporations are authorized, under prescribed regulations, to establish and maintain for the transaction of their business, branches or agencies in foreign countries, their dependencies or colonies, and in the dependencies or insular possessions of the United States, at such places as may be approved by the Federal Reserve Board.

Power to Purchase and Hold Stock

With the consent of the Federal Reserve Board, a corporation may purchase and hold stock or other certifi-

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cates of ownership in any other corporation similarly organized under the Edge Act, or under the laws of any foreign country, colony or dependency, or of any state, dependency or insular possession of the United States, where such corporation is not engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States and transacts only such business in the United States as in the judgment of the Federal Reserve Board is incidental to its international or foreign business. No corporation, however, organized under the law may invest in any one corporation an amount in excess of 10 per centum of its own capital and surplus, except in a corporation engaged in the business of banking (in which case 15 per centum of its capital and surplus may be so invested) without the approval of the Federal Reserve Board, nor purchase, own or hold stock or certificates of ownership in any other corporation organized under the law or under the laws of any state, which is in substantial competition therewith, or which holds stock or certificates of ownership in corporations which are in substantial competition with the purchasing corporation. These limitations, however, do not prevent corporations organized under the law from purchasing and holding stock in any corporation where such purchase is necessary to prevent a loss upon a debt previously contracted in good faith; and stock so purchased or acquired in corporations organized under the law shall be disposed of at public or private sale within six months

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thereafter, unless the time is extended by the Federal Reserve Board.

Limitations on Scope of Activities

None of the powers conferred by the law, except those incidental and preliminary to organization, may be exercised until the corporation is duly authorized by the Federal Reserve Board to commence business. Corporations organized under the law may not become members of the Federal Reserve System and are prohibited from carrying on any part of their business activities in the United States, except such as in the opinion of the Federal Reserve Board is incidental to their international or foreign business. They are prohibited from engaging in commerce or trade in commodities and from directly or indirectly controlling, fixing or attempting to control or fix the prices thereof. A corporation violating this provision is subject to forfeiture of its charter, and any director, officer, agent or employee thereof using or conspiring to use the credit, funds or power of the corporation to fix or control the price of such commodities, is liable to a fine of not less than $1,000 and not more than $5,000, or imprisonment for not less than one year and not more than five years, or both.

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Conversion of State Institutions

Any banking institution principally engaged in foreign business incorporated by special law of the United States, or any state, or organized under the general laws of either, having an unimpaired capital sufficient to entitle it to become a corporation under the provisions of the Edge Act may, by vote of the stockholders owning not less than two-thirds of the capital stock, upon approval of the Federal Reserve Board, be converted into a Federal corporation of the kind authorized, with any name approved by the Federal Reserve Board, where such conversion is not made in contravention of the state law. The articles of association and the organization certificate may be executed by a majority of the directors of the banking institution, the certificate containing a declaration that the owners of at least two-thirds of the capital stock have authorized the directors to make such certificate and to convert the institution into a Federal corporation. Other details in connection with the procedure to be followed in such cases are prescribed by the law. The shares of stock may continue to be for the same amount each as they were before the conversion and the directors may continue in office until others are elected or appointed, in accordance with the provisions of the law. Such corporations, upon compliance with the prescribed formalities, acquire all the powers and privileges, have the same duties and are subject to

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the same liabilities and regulations as are prescribed for corporations originally organized as Federal corporations under the statute.

Forfeiture of Franchise

The rights, privileges and franchises derived from incorporation under the law may be forfeited by failure of the corporation to comply with its provisions, but before any such corporation is declared dissolved or its rights, privileges and franchises forfeited, the noncompliance with or violation of the law must be determined by a proper court of the United States in a suit brought for that purpose, in the district or territory in which the home office is located, the suit being instituted by the Federal Reserve Board or by the Attorney General of the United States.

Insolvency and Receivership

Whenever the Federal Reserve Board becomes satisfied of the insolvency of any such corporation, it may appoint a receiver to take possession of all the property and assets, exercising the same powers with respect thereto as are now exercised by receivers of national banks appointed by the Comptroller of the Currency. Any assets, however, subject to the laws of other countries or jurisdictions shall be dealt with in accordance with the terms of such laws.

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Taxation

Corporations are subject to tax by the state in which the home office is located to the same extent as other corporations organized under the laws of that state and transacting a similar character of business. The shares of stock are subject to tax as the personal property of the owners or holders to the same extent as shares of stock in similar state corporations.

Penalties

Officers, directors, employees or agents are liable to imprisonment of from two to ten years, and a fine of not more than $5,000, in the discretion of the court, for embezzlement or misuse of funds, or issuing without authority certificates of deposit, drawing bills of exchange, making acceptances, assigning negotiable or non-negotiable instruments, or making false entries in books or reports of the corporation with intent to injure, defraud or deceive. Similar offenses by a receiver of a corporation or by his employees involving trust funds or by any person aiding or abetting in the commission of any of the above offenses are punishable in like manner.

Any person connected with a corporation who represents that the United States is liable for the payment of any bonds or other obligations or the interest thereon

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issued or incurred by any corporation organized under the law, or that the United States incurs any liability for any act or omission of the corporation, is liable to a fine of not more than $10,000 and imprisonment for not exceeding five years.

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The Edge Act

Approved December 24, 1919

An Act

To amend the Act approved December 23, 1913, known as the Federal Reserve Act.

BE IT enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Act approved December 23, 1913, known as the Federal Reserve Act, as amended, be further amended by adding a new section as follows:

"BANKING CORPORATIONS AUTHORIZED TO DO FOREIGN BANKING BUSINESS.

"Sec. 25 (a). Corporations to be organised for the purpose of engaging in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States, either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions as provided by this section, and to act when required by the Secretary of the Treasury as fiscal agents of the United States, may be formed by any number of natural persons, not less in any case than five.

"Such persons shall enter into articles of association which shall specify in general terms the objects for which the association is

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formed and may contain any other provisions not inconsistent with law which the association may see fit to adopt for the regulation of its business and the conduct of its affairs.

"Such articles of association shall be signed by all of the persons intending to participate in the organization of the corporation and, thereafter, shall be forwarded to the Federal Reserve Board and shall be filed and preserved in its office. The persons signing the said articles of association shall, under their hands, make an organization certificate which shall specifically state:

"First. The name assumed by such corporation, which shall be subject to the approval of the Federal Reserve Board.

"Second. The place or places where its operations are to be carried on.

"Third. The place in the United States where its home office is to be located.

"Fourth. The amount of its capital stock and the number of shares into which the same shall be divided.

"Fifth. The names and places of business or residence of the persons executing the certificate and the number of shares to which each has subscribed.

"Sixth. The fact that the certificate is made to enable the persons subscribing the same, and all other persons, firms, companies, and corporations, who or which may thereafter subscribe to or purchase shares of the capital stock of such corporation, to avail themselves of the advantages of this section.

"The persons signing the organization certificate shall duly acknowledge the execution thereof before a judge of some court of record or notary public, who shall certify thereto under the seal of such court or notary, and thereafter the certificate shall be forwarded to the Federal Reserve Board to be filed and preserved in its office. Upon duly making and filing articles of association and an organization certificate, and after the Federal Reserve Board has approved the same and issued a permit to begin business, the association shall become and be a body corporate, and as such and in the name designated therein shall have power to adopt and use a corporate seal,

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which may be changed at the pleasure of its board of directors; to have succession for a period of twenty years unless sooner dissolved by the act of the shareholders owning two-thirds of the stock or by an Act of Congress or unless its franchises become forfeited by some violation of law; to make contracts; to sue and be sued, complain, and defend in any court of law or equity; to elect or appoint directors, all of whom shall be citizens of the United States; and, by its board of directors, to appoint such officers and employees as may be deemed proper, define their authority and duties, require bonds of them, and fix the penalty thereof, dismiss such officers or employees, or any thereof, at pleasure and appoint others to fill their places; to prescribe, by its board of directors, by-laws not inconsistent with law or with the regulations of the Federal Reserve Board regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers and employees appointed, its property transferred, and the privileges granted to it by law exercised and enjoyed.

"Each corporation so organized shall have power, under such rules and regulations as the Federal Reserve Board may prescribe:

"(a) To purchase, sell, discount, and negotiate, with or without its indorsement or guaranty, notes, drafts, checks, bills of exchange, acceptances, including bankers' acceptances, cable transfers, and other evidences of indebtedness; to purchase and sell, with or without its indorsement or guaranty, securities, including the obligations of the United States or of any State thereof but not including shares of stock in any corporation except as herein provided; to accept bills or drafts drawn upon it subject to such limitations and restrictions as the Federal Reserve Board may impose; to issue letters of credit; to purchase and sell coin, bullion, and exchange; to borrow and to lend money; to issue debentures, bonds, and promissory notes under such general conditions as to security and such limitations as the Federal Reserve Board may prescribe, but in no event having liabilities outstanding thereon at any one time exceeding ten times its capital stock and surplus; to receive deposits outside of the United States and to receive only such deposits within the United States as may be incidental to or for the purpose of carrying out transac-

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tions in foreign countries or dependencies or insular possessions of the United States; and generally to exercise such powers as are incidental to the powers conferred by this Act or as may be usual, in the determination of the Federal Reserve Board, in connection with the transaction of the business of banking or other financial operations in the countries, colonies, dependencies, or possessions in which it shall transact business and not inconsistent with the powers specifically granted herein. Nothing contained in this section shall be construed to prohibit the Federal Reserve Board, under its power to prescribe rules and regulations, from limiting the aggregate amount of liabilities of any or all classes incurred by the corporation and outstanding at any one time. Whenever a corporation organised under this section receives deposits in the United States authorised by this section it shall carry reserves in such amounts as the Federal Reserve Board may prescribe, but in no event less than 10 per centum of its deposits.

"(b) To establish and maintain for the transaction of its business branches or agencies in foreign countries, their dependencies or colonies, and in the dependencies or insular possessions of the United States, at such places as may be approved by the Federal Reserve Board and under such rules and regulations as it may prescribe, including countries or dependencies not specified in the original organization certificate.

"(c) With the consent of the Federal Reserve Board to purchase and hold stock or other certificates of ownership in any other corporation organised under the provisions of this section, or under the laws of any foreign country or a colony or dependency thereof, or under the laws of any State, dependency or insular possession of the United States but not engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States and not transacting any business in the United States except such as in the judgment of the Federal Reserve Board may be incidental to its international or foreign business: *Provided, however,* That, except with the approval of the Federal Reserve Board, no corporation organised hereunder shall invest in any one corporation

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an amount in excess of 10 per centum of its own capital and surplus, except in a corporation engaged in the business of banking, when 15 per centum of its capital and surplus may be so invested: *Provided further*, That no corporation organized hereunder shall purchase, own, or hold stock or certificates of ownership in any other corporation organized hereunder or under the laws of any State which is in substantial competition therewith, or which holds stock or certificates or ownership in corporations which are in substantial competition with the purchasing corporation.

"Nothing contained herein shall prevent corporations organized hereunder from purchasing and holding stock in any corporation where such purchase shall be necessary to prevent a loss upon a debt previously contracted in good faith; and stock so purchased or acquired in corporations organized under this section shall within six months from such purchase be sold or disposed of at public or private sale unless the time to so dispose of same is extended by the Federal Reserve Board.

"No corporation organized under this section shall carry on any part of its business in the United States except such as, in the judgment of the Federal Reserve Board, shall be incidental to its international or foreign business: *And provided further*, That except such as is incidental and preliminary to its organization no such corporation shall exercise any of the powers conferred by this section until it has been duly authorized by the Federal Reserve Board to commence business as a corporation organized under the provisions of this section.

"No corporation organized under this section shall engage in commerce or trade in commodities except as specifically provided in this section, nor shall it either directly or indirectly control or fix or attempt to control or fix the price of any such commodities. The charter of any corporation violating this provision shall be subject to forfeiture in the manner hereinafter provided in this section. It shall be unlawful for any director, officer, agent, or employee of any such corporation to use or to conspire to use the credit, the funds, or the power of the corporation to fix or control the price of

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any such commodities, and any such person violating this provision shall be liable to a fine of not less than $1,000 and not exceeding $5,000 or imprisonment not less than one year and not exceeding five years, or both, in the discretion of the court.

"No corporation shall be organized under the provisions of this section with a capital stock of less than $2,000,000, one-quarter of which must be paid in before the corporation may be authorized to begin business, and the remainder of the capital stock of such corporation shall be paid in installments of at least 10 per centum on the whole amount to which the corporation shall be limited as frequently as one installment at the end of each succeeding two months from the time of the commencement of its business operations, until the whole of the capital stock shall be paid in. The capital stock of any such corporation may be increased at any time, with the approval of the Federal Reserve Board, by a vote of two-thirds of its shareholders or by unanimous consent in writing of the shareholders without a meeting and without a formal vote, but any such increase of capital shall be fully paid in within ninety days after such approval; and may be reduced in like manner, provided that in no event shall it be less than $2,000,000. No corporation, except as herein provided, shall during the time it shall continue its operations, withdraw or permit to be withdrawn, either in the form of dividends or otherwise, any portion of its capital. Any national banking association may invest in the stock of any corporation organized under the provisions of this section, but the aggregate amount of stock held in all corporations engaged in business of the kind described in this section and in section 25 of the Federal Reserve Act as amended shall not exceed 10 per centum of the subscribing bank's capital and surplus.

"A majority of the shares of the capital stock of any such corporation shall at all times be held and owned by citizens of the United States, by corporations the controlling interest in which is owned by citizens of the United States, chartered under the laws of the United States or of a State of the United States, or by firms or companies, the controlling interest in which is owned by citizens

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of the United States. The provisions of section 8 of the Act approved October 15, 1914, entitled 'An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes,' as amended by the Acts of May 15, 1916, and September 7, 1916, shall be construed to apply to the directors, other officers, agents, or employees of corporations organized under the provisions of this section: *Provided, however*, That nothing herein contained shall (1) prohibit any director or other officer, agent or employee of any member bank, who has procured the approval of the Federal Reserve Board from serving at the same time as a director or other officer, agent or employee of any corporation organized under the provisions of this section in whose capital stock such member bank shall have invested; or (2) prohibit any director or other officer, agent, or employee of any corporation organised under the provisions of this section, who has procured the approval of the Federal Reserve Board, from serving at the same time as a director or other officer, agent or employee of any other corporation in whose capital stock such first mentioned corporation shall have invested under the provisions of this section.

"No member of the Federal Reserve Board shall be an officer or director of any corporation organised under the provisions of this section, or of any corporation engaged in similar business organized under the laws of any State, nor hold stock in any such corporation, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement.

"Shareholders in any corporation organized under the provisions of this section shall be liable for the amount of their unpaid stock subscriptions. No such corporation shall become a member of any Federal reserve bank.

"Should any corporation organised hereunder violate or fail to comply with any of the provisions of this section, all of its rights, privileges, and franchises derived herefrom may thereby be forfeited. Before any such corporation shall be declared dissolved, or its rights, privileges, and franchises forfeited, any noncompliance with, or

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violation of such laws shall, however, be determined and adjudged by a court of the United States of competent jurisdiction, in a suit brought for that purpose in the district or territory in which the home office of such corporation is located, which suit shall be brought by the United States at the instance of the Federal Reserve Board or the Attorney General. Upon adjudication of such noncompliance or violation, each director and officer who participated in, or assented to, the illegal act or acts, shall be liable in his personal or individual capacity for all damages which the said corporation shall have sustained in consequence thereof. No dissolution shall take away or impair any remedy against the corporation, its stockholders, or officers for any liability or penalty previously incurred.

"Any such corporation may go into voluntary liquidation and be closed by a vote of its shareholders owning two-thirds of its stock.

"Whenever the Federal Reserve Board shall become satisfied of the insolvency of any such corporation, it may appoint a receiver who shall take possession of all of the property and assets of the corporation and exercise the same rights, privileges, powers, and authority with respect thereto as are now exercised by receivers of national banks appointed by the Comptroller of the Currency of the United States: *Provided, however*, That the assets of the corporation subject to the laws of other countries or jurisdictions shall be dealt with in accordance with the terms of such laws.

"Every corporation organized under the provisions of this section shall hold a meeting of its stockholders annually upon a date fixed in its by-laws, such meeting to be held at its home office in the United States. Every such corporation shall keep at its home office books containing the names of all stockholders thereof, and the names and addresses of the members of its board of directors, together with copies of all reports made by it to the Federal Reserve Board. Every such corporation shall make reports to the Federal Reserve Board at such times and in such form as it may require; and shall be subject to examination once a year and at such other times as may be deemed necessary by the Federal Reserve Board by examiners appointed by the Federal Reserve Board, the cost of such examina-

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tions, including the compensation of the examiners, to be fixed by the Federal Reserve Board and to be paid by the corporation examined.

"The directors of any corporation organized under the provisions of this section may, semiannually, declare a dividend of so much of the net profits of the corporation as they shall judge expedient; but each corporation shall, before the declaration of a dividend, carry one-tenth of its net profits of the preceding half year to its surplus fund until the same shall amount to 20 per centum of its capital stock.

"Any corporation organized under the provisions of this section shall be subject to tax by the State within which its home office is located in the same manner and to the same extent as other corporations organized under the laws of that State which are transacting a similar character of business. The shares of stock in such corporation shall also be subject to tax as the personal property of the owners or holders thereof in the same manner and to the same extent as the shares of stock in similar State corporations.

"Any corporation organized under the provisions of this section may at any time within the two years next previous to the date of the expiration of its corporate existence, by a vote of the shareholders owning two-thirds of its stock, apply to the Federal Reserve Board for its approval to extend the period of its corporate existence for a term of not more than twenty years, and upon certified approval of the Federal Reserve Board such corporation shall have its corporate existence for such extended period unless sooner dissolved by the act of the shareholders owning two-thirds of its stock, or by an act of Congress or unless its franchise becomes forfeited by some violation of law.

"Any bank or banking institution principally engaged in foreign business incorporated by special law of any State or of the United States or organized under the general laws of any State or of the United States and having an unimpaired capital sufficient to entitle it to become a corporation under the provisions of this section may, by the vote of the shareholders owning not less than two-thirds of

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the capital stock of such bank or banking association, with the approval of the Federal Reserve Board, be converted into a Federal corporation of the kind authorized by this section with any name approved by the Federal Reserve Board: *Provided, however,* That said conversion shall not be in contravention of the State law. In such case the articles of association and organization certificate may be executed by a majority of the directors of the bank or banking institution, and the certificate shall declare that the owners of at least two-thirds of the capital stock have authorized the directors to make such certificate and to change or convert the bank or banking institution into a Federal corporation. A majority of the directors, after executing the articles of association and the organization certificate, shall have power to execute all other papers and to do whatever may be required to make its organization perfect and complete as a Federal corporation. The shares of any such corporation may continue to be for the same amount each as they were before the conversion, and the directors may continue to be directors of the corporation until others are elected or appointed in accordance with the provisions of this section. When the Federal Reserve Board has given to such corporation a certificate that the provisions of this section have been complied with, such corporation and all its stockholders, officers, and employees, shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations, in all respects, as shall have been prescribed by this section for corporations originally organized hereunder.

"Every officer, director, clerk, employee, or agent of any corporation organized under this section who embezzles, abstracts, or willfully misapplies any of the moneys, funds, credits, securities, evidences of indebtedness or assets of any character of such corporation; or who, without authority from the directors, issues or puts forth any certificate of deposit, draws any order or bill of exchange, makes any acceptance, assigns any note, bond, debenture, draft, bill of exchange, mortgage, judgment, or decree; or who makes any false entry in any book, report, or statement of such corporation with intent, in either case, to injure or defraud such corporation or any

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other company, body politic or corporate, or any individual person, or to deceive any officer of such corporation, the Federal Reserve Board, or any agent or examiner appointed to examine the affairs of any such corporation; and every receiver of any such corporation and every clerk or employee of such receiver who shall embezzle, abstract, or willfully misapply or wrongfully convert to his own use any moneys, funds, credits, or assets of any character which may come into his possession or under his control in the execution of his trust or the performance of the duties of his employment; and every such receiver or clerk or employee of such receiver who shall, with intent to injure or defraud any person, body politic or corporate, or to deceive or mislead the Federal Reserve Board, or any agent or examiner appointed to examine the affairs of such receiver, shall make any false entry in any book, report, or record of any matter connected with the duties of such receiver; and every person who with like intent aids or abets any officer, director, clerk, employee, or agent of any corporation organized under this section, or receiver or clerk or employee of such receiver as aforesaid in any violation of this section, shall upon conviction thereof be imprisoned for not less than two years nor more than ten years, and may also be fined not more than $5,000, in the discretion of the court.

"Whoever being connected in any capacity with any corporation organized under this section represents in any way that the United States is liable for the payment of any bond or other obligation, or the interest thereon, issued or incurred by any corporation organized hereunder, or that the United States incurs any liability in respect of any act or omission of the corporation, shall be punished by a fine of not more than $10,000 and by imprisonment for not more than five years."

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Needed Reform in the Present Federal Tax Laws

Guaranty Trust Company
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Needed Reform in the Present Federal Tax Laws*

Measures Which Should Be Taken to Relieve Business From Unwarranted Burden of Existing Taxation

MORRIS F. FREY
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IMMEDIATE reforms in Federal taxation are necessary if business is to progress and expand sufficiently to meet the demands for increased production. To continue, during peace times, the taxation of business profits upon a war basis, means to injure American business and industry beyond reparation. All clear thinking Americans must realize that we are now passing through one of the most critical periods in American history. Social unrest is becoming more and more pronounced, and the demands of labor must be met by a division of the earnings of industry and commerce. The claims of labor cannot be satisfied if business is to be indefinitely burdened as at present, with taxes so high as to discourage

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enterprise and retard production. Nothing can help solve the present unstable social conditions better than largely increased production, but business concerns cannot be expected to accept the hazards of extensive expansion and at the same time pay to the Government a large proportion of their profits in the form of excess profits and income taxes.

Militates Against Foreign Trade

Moreover, our high taxes militate against the expansion of our foreign trade, which at this time is so important to the future prosperity of our industries. The high rates for money which are demanded by the investor because of heavy taxation, deter the opening of commercial credits and the free investment in foreign securities. In fact our own industries are precluded from financing by bond issues, except at excessive rates, which overcome, in a measure, the tax of the individual investor, and they have recently favored the raising of capital by the issue of preferred stock which is less expensive. The high rate of return on such stock also is proving attractive now to investors who formerly would invest only in high-grade bonds, thus demonstrating that high rates of tax are inclined to cultivate speculative tendencies, rather than encourage caution and thrift. And even with the inducement of high return, capital has been, to a considerable extent, diverted

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from investment in industries to investment in securities which are exempt from tax.

To retain, at this time, taxes which are so injurious to our economic welfare, is unjustifiable and immediate remedy should be afforded by Congress. Great Britain has recognized the necessity of such reform, and in the last budget there was included a provision for a 50 per cent. reduction of the war profits tax. In introducing this budget, the Chancellor of the Exchequer stated, in effect, that the existing high tax deterred enterprise, industry, and development. The statement of the Chancellor can be applied with equal force to American industry.

Repeal of Excess Profits Tax

One of the most urgent reforms in our present system of taxation is the repeal of the excess profit tax. This tax, in its present form, though probably justifiable as a means of raising revenue for the prosecution of the war, is both unscientific in principle and economically unsound. Although this tax is in the form of a direct tax on profits, it is, in effect, a most unsatisfactory commodity tax. A manufacturer or merchant or other business concern subject to the tax is required to estimate in advance the amount which he is compelled to add to the selling price of the commodity and to pass the same on to the ultimate consumer, in order to protect himself against the heavy impo-

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sition. Because of the uncertainty of the determination of tax owing to the intricacies and complexities of the law, a business concern is apt to overestimate, rather than underestimate, its liability. In doing this, it becomes an unintentional profiteer in protecting itself from an undue usurpation of its earnings. If we abolish the excess profits tax, we undoubtedly will have eliminated a potent factor in the existing high cost of living.

Penalizing Credit

Furthermore, the excess profits tax law, as framed, penalizes credit. It says, in effect: "If you are a corporation whose credit is good, and you expand your business through loans, we will give you no allowance for capital so raised and employed, but we will tax you on your profits to the same extent as if this borrowed capital did not exist." On the other hand, a concern which is unable to borrow may get the full benefit of all capital which is invested in the business by the stockholders. There is no question that the income of the first business may be increased directly by the investment of borrowed money made possible by the borrowing ability of the corporation. Yet, the corporation in the second instance, which has no credit, will have the same exemption and will be taxed at proportionately lower rates than the first corporation. The law, with its present limitations on invested capital, not only gives no

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recognition to a concern which can expand its business by credit, but unjustly imposes a heavier burden upon such business than upon a business which is unable to obtain credit. This is but another flagrant example of the tendency of this law to deter expansion and thus retard production.

Many Inequalities Produced by Excess Profits Tax

The inequalities produced by the excess profits tax law are so many that it is impossible to enumerate all of them. In fact, they become more apparent with the age of the law. The effect of the application of the excess profits tax is often the result of chance in the organization of the corporation, or the age of the corporation. For example, a corporation organized in 1912, having no knowledge of the form which future revenue legislation would take, may have capitalized at $500,000 and issued bonds for an additional $500,000. A competing corporation, engaged in identically the same business, may have organized at the same time, capitalizing at $1,000,000 by issuing $500,000 in common stock and $500,000 in preferred stock, instead of bonds. In the first case, provided the surplus and undivided profits of the two corporations are the same, the invested capital of the corporation issuing bonds will be $500,000 less than the invested capital of the corporation which

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issued preferred stock. If the net income of the two competing corporations is the same, the tax on the latter corporation will be reduced because of the difference in the invested capital. Here we have two corporations with the same amount of capital originally invested and employed in the business, one of which is taxed in excess of the other because of the nature of its capital.

Again, we may take a corporation organized in 1904 with a paid-in capital of $2,500,000. The actual value of the property paid in, consisting of plant and other property, on January 1, 1919, due to appreciation, is $5,000,000. In 1918, a corporation engaged in the same business is organized with a paid-in capital of $5,000,000 invested in plant and other tangible property of equal value. Although the capital invested at the beginning of the taxable year is the same in each corporation, the corporation organized in 1904 is allowed to include in invested capital for excess profits tax purposes only the original $2,500,000 paid in, without taking into consideration the increased value of its assets due to appreciation. The corporation organized in 1918, with assets of no greater value than the other corporation, may compute its excess profits tax on the basis of a $5,000,000 capitalization. The excess profits tax at the rates for 1919, assuming that each corporation earns $1,500,000, will be $459,400 for the corporation organized in 1904, and $319,400 for

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the corporation organized in 1918, although the business is the same and the assets and earnings of the corporations are of like amounts.

Inequalities Affecting Good-Will, Trade Marks, Etc.

Inequalities also exist in many cases of corporations which, through long established business, have built up valuable good-will and trade marks, and of newly organized corporations which have purchased assets of going concerns, including good-will and trade marks. For example, a corporation may have been in existence for twenty-five years and have acquired, through extensive advertising and reputation for service and business methods, good-will of a market value of $1,000,000. The value of this good-will cannot be considered in the computation of invested capital. The following year a going corporation may purchase the assets of the first corporation, paying for the good-will the sum of $1,000,000 cash. This corporation would be entitled to include the value of the good-will so purchased as invested capital. Many cases now exist in which valuable good-will with immense earning power cannot be considered in the computation of invested capital, whereas other corporations which have purchased good-will for cash are allowed to include such good-will

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at its cost, thus working a particular hardship on many competing corporations.

The practice also of assessing different forms of business organization by different methods of taxation, as at present, produces inequalities in competing firms and corporations. For instance, a corporation having invested capital of $50,000 and profits of $20,000 would pay a tax of $4,680 based on the 1919 rates, whereas if the same business were conducted by two partners, each sharing equally in the profits and having no other income, the tax paid by each would be approximately $590, or a total tax of $1,180. In this case the corporation is taxed more than 300 per cent. higher than a partnership engaged in the same business would be taxed. This is true in the case of smaller corporations. In certain cases, however, a partnership whose earnings are large will be taxed higher than a corporation whose stock is held in the same proportion as the interest of the individual partners in the partnership.

Aside from the fundamental objections to the excess profits tax, the administration of the law is both difficult and intricate. The computation of a tax, based on invested capital arbitrarily defined and net income, is necessarily so complicated as to be practically unintelligible to the average business man who has neither the time nor the inclination to work out the problems with which he is confronted in the preparation of his tax return. This

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is especially true with respect to placing a valuation on invested capital.

Excessive Burdens Imposed on Incomes

Based on the estimates of the Administration, approximately 35 per cent. of the cost of the war has been borne by current taxation. This is a greater amount than the original program called for, and is due largely to the ease with which a legislature may increase the rates of taxation on incomes without realizing the ultimate effect of the high assessment. To continue to raise such enormous sums of revenue by means of an assessment on incomes will place a greater burden on posterity by impeding the industrial growth of the country than would the passing to them of a larger contribution to the war debt than is now contemplated.

The entire elimination of a tax on income is, of course, not to be considered, as income taxes must be recognized to have become a permanent part of our Federal revenue system. Such taxes, however, must be kept within reasonable limits, and where revenue is needed beyond an amount which may be properly and logically raised by this means, other sources of taxation should be considered. Unquestionably, our present rates of tax are unduly oppressive to business, and if the amount of revenue now estimated to be necessary to keep

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our Government functioning must be forthcoming, other methods of taxation should be adopted.

Gross Sales Tax Recommended

Ample revenue may be raised and our excess profits tax abolished and income tax lowered by the enactment, in lieu thereof, of a consumption tax, in the nature of a tax on gross sales. It is estimated that a general consumption tax, based on gross sales, at the rate of 1 per cent., would yield amounts varying from $1,250,000,000 to $3,500,000,000 annually, depending upon the extent of the application of the tax, the former amount being realized if the tax were confined exclusively to retail sales, and the latter amount if applied to all turnovers. A tax of this character is so evenly distributed that it would be felt but little; at the same time it would be most productive. In most cases the tax would be passed on to the consumer, who would pay the small assessment as a part of the cost of the product. It would be so light, however, that it would hardly be realized. In many cases the amount paid would be so small that the cost of the goods would probably not be increased, but the tax would be borne by the seller or producer. In all cases competition could be depended upon to prevent any excessive increases in the cost of products or merchandise on account of the tax.

In addition to the uniformly equitable character of the tax, the administration and enforcement of

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a law of this character would be simple and would relieve both the public and the Government from the unnecessary confusion and expense incidental to a law involving the intricate and complex provisions of the excess profits tax. With the reduction of the expenses of the Government which will come with the resumption of normal conditions, the gross sales tax may be repealed and the needs of the Government met by the revenue derived from income taxes and import duties.

Remove Tax on Reorganizations

In addition to the elimination of the excess profits tax and a general reduction of income tax, a number of objectionable features in the present law should be remedied by legislation. One of the most important of these is the repeal of Section 202 (b), which provides that taxable income shall accrue when, in the case of any reorganization, merger, or consolidation of a corporation, a person receives, in place of stock or securities or securities owned by him, new stock or securities having a par or face value in excess of the aggregate par or face value of the stock or securities exchanged. In such case the law now provides that a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market

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value of the new stock or securities is greater than the cost or fair market value on March 1, 1913, of the stock or securities exchanged. This provision is holding up many reorganizations, consolidations, and mergers, because stockholders refuse to run the risk of paying a large tax on a paper profit which has not been realized.

This provision should be eliminated for two reasons: First, it is doubtful if any taxable income accrues within the meaning of the law; and, second, it prevents desirable rearrangements of business which are essential at the present time to industrial expansion. The stockholder in the case of a reorganization or consolidation receives only a certificate of stock evidencing an interest in the same property the ownership of which was evidenced by the certificate which he has surrendered. There is no separation of the capital invested in the stock and the appreciation in the value of the stock exchanged which is essential to the realization of income within the meaning of the taxing act. In other words, the exchange of stock is merely an exchange of an evidence of the ownership of an interest in the same property.

There is a decided difference in an exchange of securities under these conditions, and an exchange of a readily marketable security of one kind for a marketable security of another. In the latter case, it would be possible in many cases for a person to avoid paying any tax on an exchange of invest-

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ments if, instead of selling a stock outright, he should arrange to exchange it for the stock of another corporation of an equal market value.

The existence of this provision has been the cause of various methods being adopted to avoid payment of tax in the case of a reorganization consolidation, or merger. One of these methods is the incorporation under the law of a state under which stock of no par value may be issued without requiring a corporation to fix in a certificate, or on its books of account or otherwise, an amount of capital or an amount of stock issued which may not be impaired by the distribution of dividends. The Department has recognized in its regulations this method of reorganization as possible, without the payment of tax. If, however, a corporation does not desire to adhere to these conditions, it is necessary for the stockholders either to refrain from reorganization or to submit in many cases to an extremely high tax on profits which are not realized.

Present Tax on Profits from Sale of Capital Assets

A change in the law should also be made in the method of assessing profits derived from the sale of capital assets. Under the present law the profits realized from the sale of capital assets are subject to tax at the rates effective for the year in which such property is sold, regardless of the

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fact that such profits may be derived from the sale of property acquired many years ago. To tax, at the very high rates now existing, profits accrued over a period of years, is not only unfair, but has prevented the sale of property which otherwise would have changed hands. The result is that the Government receives no revenue in such cases, and improvements which would result from such transfers are prevented. An equitable method of assessment should be adopted. The fairer method, undoubtedly, would be to prorate the profits over the period during which the property has been held and assess and collect tax on the proportionate profits attributable to the particular year at the rates effective for such year. By this means an accumulation of profits for a number of years would not be assessed as a whole in one year. Other methods have been suggested, but this would seem to be the most equitable.

Taxation of Non-resident Income

With the increasing popularity of income taxation throughout the world it has become imperative that uniformity should exist in the methods of taxing non-residents. Dual taxation can be averted only by the nations which impose an income tax, recognizing the laws of one another to the extent that income should have but one situs for the purpose of taxation. Under existing laws it is not an uncommon incident to see the English and Ameri-

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can income tax exceed the net income of the taxpayer. To remedy this condition, a uniform practice of taxing nonresident aliens should be considered and adopted at an early date by a *commission composed of representatives from all countries imposing an income tax.*

There is no question that on income derived from business engaged in or transacted in a foreign country a non-resident alien should be required to pay a tax to the country in which he is carrying on such business and in which he derives the income. He should, however, not be required to pay tax again on this income to another country. To a certain extent, this has been remedied by our present income tax law, so far as citizens of the United States living in this country are concerned, but the law should be amended to give complete relief in all cases.

An entirely different situation exists, however, in the case of taxation of income derived from stocks and bonds of domestic corporations owned by non-resident aliens. Under the Federal income tax law of 1913 as interpreted by the Attorney General of the United States, the income from stocks and bonds of domestic corporations owned by non-resident aliens was not subject to tax. The Treasury Department, however, in 1916, refused to follow longer the opinion of the Attorney General and insisted upon the collection of tax on such income. In the Act of 1916 and the Act

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of 1918 such income was made specifically subject to tax. Prior to the war, American securities in large volumes were purchased and held in foreign countries. and when the proper time arrives, we will again desire to market securities in foreign fields. The present tax, if retained, so discriminates against American securities that it will seriously interfere with their marketability abroad, and it is therefore of vital interest to this country that this provision of the law should be repealed.

Tax on Interest of Non-resident Alien Bank Deposits

The phase of the tax on non-residents which is now probably of greater concern than any other is the tax on interest on bank deposits of non-resident aliens. The continuance of a tax of this character is injurious to the general industrial prosperity of the country and particularly to the promotion of foreign trade. In the first place, a bank's deposits constitute a part of its operating capital, and any governmental policy which tends to decrease the amount of such deposits has a detrimental effect, not only upon the bank itself, but also upon all collateral lines of business.

At the present time export credit is an important factor in the United States and anything which tends to check such credit is disastrous to the foreign trade of this country. To satisfy the

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demands of American exporters, in many cases, it is necessary that foreign deposits be maintained in New York. As a matter of practice, many American exporters insist upon receiving payment in New York for goods destined for overseas markets. In order to meet this situation, the foreign buyer, through his local bank, has money on deposit in New York and arranges for the seller in the United States to draw here, the New York bank debiting the foreign account accordingly.

It is not attractive to the European banker to place his money, in normal times, in a country where he is required to pay a tax on the interest which he receives on his balance, and it is not unlikely that he will instruct his customers to purchase in some other market. If the situation is not remedied there is grave danger that many of these foreign banks will transfer their accounts to banks outside of the United States where such tax is not imposed.

The benefits derived from this tax because of the revenue which it produces are entirely disproportionate to the detrimental effects produced upon the instrumentality upon which it is levied. The amount which the tax produces is comparatively small. The amount of income, however, derived indirectly from such deposits is large. If these deposits are removed, the Government will lose not only the tax on the interest on such deposits, but will lose a very much heavier tax on the

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profits which American business concerns derive indirectly from the maintenance of such deposits in this country. It is advisable, therefore, not only from the point of view of American industry but from the point of view of the United States Government that these objectionable features of our Federal law be immediately repealed. Other changes in the law to prevent dual taxation of non-residents are desirable, but those stated above are of the greatest importance at the present time.

A Single Graduated Tax Preferable

In addition to the fundamental defects in the present system of taxation which have been suggested, certain changes may well be made in the present law which will be of marked advantage from the standpoint of simplicity and ease of administration. A most desirable change is the form of the present income tax. The existing law in effect provides for two separate taxes, a normal tax and a graduated surtax. This distinction is confusing to the taxpayer and results in unnecessary complications with respect to the computation of the tax. The reason for differentiating between those two classes of taxes, under the original income tax law, was for the purpose of the collection of tax at the source. As the collection of tax at the source has been abolished, with the exception of tax on the income of a non-resident alien, and interest on "tax free" covenant bonds,

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the classification of normal and surtax is no longer necessary or advisable. The law could be amended to provide for a single graduated income tax, with proper credits for tax on account of income derived from dividends on stocks of domestic corporations and interest on Liberty Bonds, which would simplify the existing provisions by eliminating a useless distinction.

Among other amendments of the law which are advisable is the continuance of the present provision of the law, expiring in 1920, which permits the allowance of a net loss in one year against the net income of the following or preceding year, and the extension of the period of thirty days from date of discovery to one year from such date within which the fair market value of mines, oil and gas wells, must be determined for the purpose of the depletion allowance.

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Amortization

Some notes of interest to investors, executors, trustees, and beneficiaries under trusts

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PARIS OFFICE
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BRUSSELS OFFICE
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Amortization

IN the absence of specific instructions in deeds of trust or wills, those charged with the administration of trust funds are required by the laws of the State of New York to invest in:

(a) Bonds and mortgages on unincumbered real property in this State worth 50% more than the amount loaned thereon.

(b) Bonds which are legal investments for savings banks in New York State.

The latter class of investments, on account of the nature of the security, commonly commands a premium, which is lost if the bonds are held until maturity. This loss must be charged either against principal or income. If charged against income, it should not be written off at one time, but should be absorbed by amortization.

Amortization, as herein discussed, is the gradual charging off and extinction of the premium paid for a bond, by setting aside at each interest period a certain amount of the fixed interest the bond bears, the amounts set aside being so calculated that at the maturity of the bond they will equal the premium paid.

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Under decisions handed down by the Court of Appeals of this State, it has been held that in the absence of a clear direction in a will to the contrary, where a testamentary trustee purchases, at a premium, bonds having a term of years to run, such a proportionate deduction should be made from the fixed interest at each interest period as will amount, at the maturity of the bond, to the premium paid, and thus preserve the principal of the fund intact; in other words, the premium should be amortized.[1]

The language of the will and the surrounding circumstances might indicate a different intention on the part of the testator, in which case his intent would control, but to justify an exception to the rule, the intent should be expressed in the very clearest manner.[2]

The failure of the testator to cause it to appear clearly in the will whether the wearing away of premiums should fall upon principal

[1] The Courts have held that when securities purchased by the creator of the trust are received by the trustee the whole interest received should be treated as income and that the life tenant should not be charged with any part of the premium at which such securities may have been inventoried.

[2] If it is desired that the life tenant shall receive the full income from securities purchased at a premium without providing for the gradual extinction of such premium so as to bring them to par at maturity, the intent should be declared in phraseology such as the following:

"The trustee named herein is hereby directed to charge all premiums on investments against principal and not against income."

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or income, has given rise to litigation and has necessitated the construction of wills by the Court, after considering the condition of the parties in interest and the surrounding circumstances, in order to determine the relative rights of life tenants and remaindermen. In some cases the expense to the estate has been greater than the amount involved. When it is incumbent upon a trustee to preserve the principal of the estate intact, the object is the protection of the remaindermen.

For instance, if a $1,000 bond having 20 years to run, bearing interest at 4% payable semi-annually, were purchased at 110% or for $1,100, when the bond matures and is paid at its face or par value, the $100 premium would be lost if it had not been amortized, and the estate would thus be depleted to the injury of the remaindermen.

The interests of the life tenant must also be considered.

If the trustee charged the whole amount of the premium paid, against accumulated income at the time of the purchase in the instance above given, he would exhaust the semi-annual interest received on the bond for two and one-half years. If the life tenant died during or at the end of that time he would have received no return whatever from the investment; therefore, the premium should be reduced gradually, i. e., by amortization.

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If a bond is purchased above par, the rate of interest earned on the sum invested is less than the rate of interest the bond pays on its face or par value. The rate of interest earned on the *sum invested*, as distinguished from the rate of interest received on the *par value* of the bond is termed *the basis*. To determine the basis it is necessary to know:

First, the purchase price of the bond.
Second, the fixed interest it bears.
Third, the number of interest payments during year.
Fourth, the number of years to maturity.

These facts being ascertained, the basis may be found in a table of bond values.

If a bond of the par value of $1,000, maturing in seven years, bearing interest at 5% payable semi-annually, is purchased for $1,060.53, the investment earns only 4%. The bond has been purchased on a 4% *basis*.

At the end of the first six months the interest earned on the investment is $21.21 (at the rate of 4% per annum on $1,060.53), the interest received on the par value of the bond is $25.00, the difference between the two amounts being $3.79.

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The theory of scientific amortization is that the difference between the interest earned on the investment and the interest received on the par value (in the example given, $3.79) is not income but principal. As a bond purchased above par approaches maturity there is an inherent and intrinsic depreciation in its value, and the amount of this depreciation at each interest period is the difference between the "interest *earned*" and the "interest *received*." This may be proven by reference to tables of bond values, where it will be seen that:

The value of a 5% bond purchased on a 4% basis with seven years to run is	$1060.53
The value of the same bond with six and one-half years to run is.....	1056.74
The depreciation during the first interest period is therefore.....	$3.79

On the theory that this amount ($3.79) is principal, it should not be paid to the life tenant, but should be returned to the principal of the estate for reinvestment, thereby reducing the cost of the bond, as shown by the trustee's books. The income from this reinvestment would, of course, be paid to the life tenant.

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This gives rise at each interest period to a new book value upon which the life tenant receives interest at the basic rate, and the difference between this sum and the interest received on the par value of the bond is returned to principal for reinvestment. If this process is continued to the maturity of the bond, the book value becomes the par value, and the amount returned to principal exactly equals the premium paid.

From the example given in TABLE I (on page 12) it will be seen that in Scientific Amortization:

(1) the amount to be paid the life tenant at each interest period from the bond is always at the basic rate on the book value;

(2) the amortization at each period is always the difference between the interest on the par value of the bond, and the interest on its book value at the basic rate;

(3) the book value of the bond at any given period is always the sum the estate would receive, if the bond were sold on the same basis at which it was purchased;

(4) at any period the book value of the bond

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and the aggregate of the amounts set aside by amortization exactly equal the amount of the original investment;

(5) at the maturity of the bond the total amount of the amortization fund equals the amount of the premium paid for the bond.

In Pro-rata Amortization as shown in TABLE II (on page 13) the premium is divided by the number of interest periods during the term of the bond and the quotient is the amount to be written off the cost of the bond and set aside for re-investment at each interest period.

By comparison, it will be seen that in scientific amortization the amount of income to be paid the life tenant from the bond, whose premium is being amortized, decreases at each interest period, while in pro rata amortization it remains the same.

In the scientific method the bonds, whose premium is being amortized, are always carried on the trustee's books at the basis of purchase, that is, the book value is decreased at each interest period by the amount of the

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amortization. The amount of interest to be paid the life-tenant from the bonds is calculated on the book value at the rate at which the original investment was made, and, therefore, his income from that source decreases at each interest period; but in addition to the interest on the book value of the bonds, he receives the interest from re-investment of the amortization fund. As that fund added to the book value of the bonds always equals the amount of the original investment, the total income paid to the life-tenant is always at the basic rate on the amount of the original investment. The values given in bond tables are computed on the basis of re-investment of the amortization fund, at the same basic rate, and such re-investment is therefore an essential of scientific amortization.

In the pro-rata method the bonds are not carried on the trustee's books at the actual basis of purchase, inasmuch as the periodic amortization is only approximated; and because the amortization deducted from the bond interest at each period in this method, is

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always the same, the income to be paid the life-tenant from the bonds does not vary. The interest on the amortization fund, however, increases at each period, and, therefore, the total income paid to the life-tenant is less during the earlier, and more during the later periods than is warranted by the actual return on the investment.

When applied to small amounts of bonds of short maturity, the pro-rata method does substantial justice as between life-tenants and remaindermen, and complies with the legal requirements; but from the examples given in Tables III and IV (on pages 14 and 15), it will be seen that, when large amounts are involved, the scientific method must be used to do justice to all parties.

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TABLE I

SCIENTIFIC AMORTIZATION OF THE BOOK VALUE OF BONDS PURCHASED AT A PREMIUM

EXAMPLE: $1,000, 5% bond, with seven years to run, purchased January 1, 1913, on a 4% basis

	Interest on Par Value	Interest at 4% on Book Value	Scientific Amortisation	Book Value	Par Value
Jan. 1, 1913	Cost...	.....	.....	$1,060.53	$1,000
July 1, 1913	$25	$21.21	$3.79	1,056.74	
Jan. 1, 1914	25	21.14	3.86	1,052.88	
July 1, 1914	25	21.05	3.95	1,048.93	
Jan. 1, 1915	25	20.98	4.02	1,044.91	
July 1, 1915	25	20.90	4.10	1,040.81	
Jan. 1, 1916	25	20.82	4.18	1,036.63	
July 1, 1916	25	20.73	4.27	1,032.36	
Jan. 1, 1917	25	20.65	4.35	1,028.01	
July 1, 1917	25	20.56	4.44	1,023.57	
Jan. 1, 1918	25	20.47	4.53	1,019.04	
July 1, 1918	25	20.38	4.62	1,014.42	
Jan. 1, 1919	25	20.29	4.71	1,009.71	
July 1, 1919	25	20.19	4.81	1,004.90	
Jan. 1, 1920	25	20.10	4.90	1,000.00	
	$350	$289.47	$60.53 = Premium paid at purchase		

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TABLE II

PRO-RATA AMORTIZATION OF THE BOOK VALUE OF BONDS PURCHASED AT A PREMIUM

EXAMPLE: $1,000, 5% bond with seven years to run, purchased January 1, 1913, on a 4% basis.

	Interest on Par Value	Interest less Pro-rata Amortisation	Pro-rata Amortisation	Book Value	Par Value
Jan. 1, 1913	Cost....	.....	.....	$1,060.53	$1,000
July 1, 1913	$25	$20.63	$4.37	1,056.16	
Jan. 1, 1914	25	20.68	4.32	1,051.84	
July 1, 1914	25	20.68	4.32	1,047.52	
Jan. 1, 1915	25	20.68	4.32	1,043.20	
July 1, 1915	25	20.68	4.32	1,038.88	
Jan. 1, 1916	25	20.68	4.32	1,034.56	
July 1, 1916	25	20.68	4.32	1,030.24	
Jan. 1, 1917	25	20.68	4.32	1,025.92	
July 1, 1917	25	20.68	4.32	1,021.60	
Jan. 1, 1918	25	20.68	4.32	1,017.28	
July 1, 1918	25	20.68	4.32	1,012.96	
Jan. 1, 1919	25	20.68	4.32	1,008.64	
July 1, 1919	25	20.68	4.32	1,004.32	
Jan. 1, 1920	25	20.68	4.32	1,000.00	
	$350	$289.47	$60.53	= Premium paid at purchase	

NOTE: In this case the first amortisation is charged with the odd cents arising from the division of $60.53 by 14

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TABLE III

SCIENTIFIC AMORTIZATION OF THE BOOK VALUE OF BONDS PURCHASED AT A PREMIUM

EXAMPLE: $100,000, 5% bonds with seven years to run, purchased January 1, 1913 on a 4% basis.

	Book Value	Interest on Par Value	Scientific Amortization	Interest at 4% on Book Value	Int. at 4% on Amort. Fund	Total Int. to Life Tenant 4% on Cost
Jan. 1, 1913	$106,053.12	Cost	.....	.....	.....	.....
July 1, 1913	105,674.19	$2,500	$378.93	$2,121.07	$ 0.00	$2,121.07
Jan. 1, 1914	105,287.67	2,500	386.52	2,113.48	7.59	2,121.07
July 1, 1914	104,893.42	2,500	394.25	2,105.75	15.32	2,121.07
Jan. 1, 1915	104,491.29	2,500	402.13	2,097.87	23.20	2,121.07
July 1, 1915	104,081.12	2,500	410.17	2,089.83	31.24	2,121.07
Jan. 1, 1916	103,662.74	2,500	418.38	2,081.62	39.45	2,121.07
July 1, 1916	103,236.00	2,500	426.74	2,073.26	47.81	2,121.07
Jan. 1, 1917	102,800.72	2,500	435.28	2,064.72	56.35	2,121.07
July 1, 1917	102,356.73	2,500	443.99	2,056.01	65.06	2,121.07
Jan. 1, 1918	101,903.86	2,500	452.87	2,047.13	73.94	2,121.07
July 1, 1918	101,441.94	2,500	461.92	2,038.08	82.99	2,121.07
Jan. 1, 1919	100,970.78	2,500	471.16	2,028.84	92.23	2,121.07
July 1, 1919	100,490.20	2,500	480.58	2,019.42	101.65	2,121.07
Jan. 1, 1920	100,000.00	2,500	490.20	2,009.80	111.27	2,121.07
Amortization	6,053.12	$35,000	$6,053.12	$28,946.88	$748.10	$29,694.98
Plus Par Value=Cost	$106,053.12					

Note: Total Interest to the Life Tenant by this method is the same at each interest period.

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TABLE IV

PRO-RATA AMORTIZATION OF THE BOOK VALUE OF BONDS PURCHASED AT A PREMIUM

EXAMPLE: $100,000, 5% bonds with seven years to run, purchased January 1, 1913 on a 4% basis.

	Book Value	Interest on Par Value	Pro-rata Amortization	Int. on Par Value Less Amortization	Int. at 4% on Amort. Fund	Total Interest to Life Tenant
Jan. 1, 1913	$106,053.12	Cost	.....	.....	.....	.....
July 1, 1913	105,620.68	$2,500	$432.44	$2,067.56	$0.00	$2,067.56
Jan. 1, 1914	105,188.32	2,500	432.36	2,067.64	8.65	2,076.29
July 1, 1914	104,755.96	2,500	432.36	2,067.64	17.30	2,084.94
Jan. 1, 1915	104,323.60	2,500	432.36	2,067.64	25.94	2,093.58
July 1, 1915	103,891.24	2,500	432.36	2,067.64	34.59	2,102.23
Jan. 1, 1916	103,458.88	2,500	432.36	2,067.64	43.24	2,110.88
July 1, 1916	103,026.52	2,500	432.36	2,067.64	51.88	2,119.52
Jan. 1, 1917	102,594.16	2,500	432.36	2,067.64	60.53	2,128.17
July 1, 1917	102,161.80	2,500	432.36	2,067.64	69.18	2,136.82
Jan. 1, 1918	101,729.44	2,500	432.36	2,067.64	77.82	2,145.46
July 1, 1918	101,297.08	2,500	432.36	2,067.64	86.47	2,154.11
Jan. 1, 1919	100,864.72	2,500	432.36	2,067.64	95.12	2,162.76
July 1, 1919	100,432.36	2,500	432.36	2,067.64	103.77	2,171.41
Jan. 1, 1920	100,000.00	2,500	432.36	2,067.64	112.42	2,180.06
Amortization	6,053.12	$35,000	$6,053.12	$28,946.88	$786.91	$29,733.79

Plus Par Value = Cost $106,053.12

Note: Total Interest to the Life Tenant by this method varies at each interest period.

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A Bank Catechism

Guaranty Trust Company
of New York

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A Bank Catechism

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A Bank Catechism

NOTE:—The purpose of this catechism is a simple presentation of the general fundamental principles of banking without attempting to cover all of the technical ramifications.

Q. *What is a Bank?*

A. A bank is an institution chartered by a State or the National Government, which accepts the care of money belonging to individuals, firms and corporations, thereby, among other things, relieving them of the risk of keeping large sums of money in their possession. It is also the medium through which nearly all general business transactions are ultimately cleared. Without the facilities afforded by banks the business of the country would be at a standstill.

In the very early days of civilization all commerce was conducted by barter, trading one product for another. Later came the creation of money, which greatly advanced the operations of commerce as it provided a medium permitting the sale of a commodity to one person or in one place, and the purchase of some other commodity from another person or in some other place, thereby affording a wider market and more opportunities for profit. The possession or transportation of money, however, subjected the owner to risk of theft and loss of life, and ultimately

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banks were organized in which the money could be deposited for safekeeping and the owner of the money could pay his debts by writing an order on the bank to pay a stated amount of his money to whomever he designated and thereby be relieved of all risk from having large amounts of money in his possession. These written orders ultimately became known as checks and today form one of the most important mediums for transacting business.

Q. *Is there more than one kind of a bank?*

A. There are many kinds of banks. There is the bank of deposit, described in a general way in the foregoing paragraph, and there are savings banks, trust companies, private banks, banks of discount, acceptance banks, and the Federal Reserve Banks.

Q. *How does a savings bank differ from other banks?*

A. A savings bank is one in which people deposit money that they do not expect to use immediately and upon which they can receive a higher rate of interest than is generally allowed by banks of deposit.

Q. *Why can a savings bank pay a higher rate of interest?*

A. The principal reasons are that most of the money is deposited for long periods and, because of

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the inactive nature of the accounts, the clerical work in a savings bank is less than in a bank of deposit, and consequently its expenses are much less, as the accounts are inactive.

Q. *What is meant by money deposited in savings banks for long periods?*

A. Usually savings bank accounts are started with small sums and are added to as money is saved against the proverbial "rainy day." Consequently, the money usually remains until there is urgent need for it, or until enough has accumulated to warrant investment in some bond or business.

Q. *If savings banks pay more interest, why does not everyone use a savings bank instead of a bank of deposit?*

A. If savings banks were used for commercial purposes their expenses would be so large they would be unable to pay the higher interest, and, besides, the method of transacting business by a savings bank is entirely different. In a savings bank the usual method of withdrawing money is upon the presentation of a bank book, and it can readily be seen that commercial business could not be transacted in that manner.

Q. *What is the difference between a State Bank and a National Bank?*

A. The principal differences between State and National banks are:

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A State bank is chartered by the State in which it is located and is subject to the laws of the State and examinations by State authorities. A National bank is authorized by act of Congress and is part of the Federal Reserve System, while a State bank may or may not belong to such system.

A State bank cannot issue bank notes, which a National bank may do, although under the Federal Reserve Act of 1913 the major portion of the notes are now issued through the Federal Reserve Banks.

Q. *Why did the Federal Reserve Act change the method of issuing money?*

A. Prior to the passage of the act, there were, generally speaking, two kinds of paper money in circulation—notes issued by the Treasury of the United States secured by the deposit of gold and silver and known as gold or silver certificates, and notes issued by National banks secured by certain United States Government bonds. These forms of currency were not sufficiently elastic and were incapable of expansion and contraction to meet the fluctuating demands of business, partly because of the amount of notes that could be issued by National banks was limited by the amount of the capital of the banks and only certain United States Government bonds had circulation privileges, and partly because of the element of profit or loss entering into the issue of bank notes.

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Q. *How did the element of profit enter into the issuance of bank notes?*

A. A National Bank could issue notes only by the deposit of an equal amount of United States Government bonds with the Treasury Department in Washington. For instance, a bank desiring to issue $100,000 bank notes would purchase $100,000 United States Government bonds which might cost it, say, $105,000, as such bonds usually sold at a premium. It would deposit these bonds in Washington and receive $100,000 in bank notes with the bank's name engraved thereon, and it would have back $100,000 of the $105,000 it paid for the bonds. These bonds usually carried 2% interest, which the bank would receive, or $2,000 per annum, against which it would have invested only $5,000.

On the other hand, it must get back out of the interest it received the $5,000 premium it had paid on the bonds; it must keep a redemption deposit with the Treasury Department in Washington equal to 5% of the notes outstanding; it must pay a circulation tax on the amount of notes outstanding, and it was obliged to pay part of the expense of operating the Redemption Bureau in Washington. If money were in demand and interest rates were high and the bank did not pay too much premium for the bonds it purchased, then the issue of bank notes was profitable. But if there were not much demand for money, the bank

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notes would lie idle in the bank vaults, or if the notes were retired the bank would have its money invested in Government bonds paying only 2%, or possibly sustain a loss if the bonds were sold.

As the price of Government bonds was a material factor in the determination of the profit in issuing bank notes, and as the price of bonds would often decline when business was slack and currency plentiful and be high when business was active and currency in demand, it frequently produced an inverse elasticity at the times when business needed an increase of currency.

Q. *How did the Federal Reserve Act change the issue of currency?*

A. In addition to the gold and silver certificates, Federal Reserve notes can now be issued secured by 40% in gold and 60% in agricultural, industrial and commercial notes, drafts, bills of exchange or acceptances. These notes can also be secured by 100% in gold.

Q. *Why is this an improvement over the old method of issuing bank notes?*

A. It provides greater elasticity and facilitates the transaction of business when there is a heavy call for money and, as the demand for money to move crops, etc., eases off and the crops are paid for, the amount of Federal Reserve notes outstanding is automatically reduced. In the past,

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the expansion in bank notes was not only governed by the element of profit but was also limited by the amount of capital stock of the National banks and Government bonds having circulation privileges, and if money was needed beyond that point it was not available—with resultant failures and panics.

Under the Federal Reserve Act, paper arising out of business transactions, subject to certain restrictions making it eligible, can be taken by a member bank to the Federal Reserve Bank and be exchanged for Federal Reserve notes. The Federal Reserve Bank in turn pledges 60% of such paper, together with 40% of gold, with the United States Government as collateral for the Federal Reserve notes, which are issued for the full amount, or notes may be issued for the full amount as long as a 40% gold reserve is maintained.

Q. *How are Federal Reserve notes automatically retired?*

A. In theory, the Federal Reserve notes issued when the individual's note was discounted or pledged with the Federal Reserve Bank, would be used to pay off such note at its maturity and the individual would get back his note and the Federal Reserve Bank would get back the Federal Reserve notes which were issued, which would be sent to Washington for redemption and cancella-

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tion and everything would be the same as before the individual's note was taken to the Federal Reserve Bank.

As a practical matter, it is not possible to use the identical Federal Reserve notes to pay off the individual's note at maturity, nor is it practicable always to pay off the note with the Federal Reserve notes which have been issued through any particular Federal Reserve Bank. Therefore, Federal Reserve notes issued through any Federal Reserve Bank can be used for this purpose, so that the individual is relieved of the task of hunting around to secure any particular Federal Reserve notes and the burden of sorting out the notes falls on the Federal Reserve Banks.

As a matter of practice, the individual merely gives his check to the bank which took his note in the first place and the bank makes the necessary settlement with the Federal Reserve Bank. This assorting of the notes of Federal Reserve Banks is accomplished by a requirement that all Federal Reserve notes issued through one Federal Reserve Bank and received by another Federal Reserve Bank shall promptly be returned to the Federal Reserve Bank through which they were originally issued, or upon instructions from such Federal Reserve Bank, they shall be sent direct to the Treasurer of the United States to be retired.

In this way, each Federal Reserve Bank can regulate the amount of its Federal Reserve notes

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to be retired and keep the total amount outstanding in conformity with the amount of paper pledged thereunder. Of course, when a Federal Reserve Bank takes in the Federal Reserve paper issued through some other Federal Reserve Bank it is paid, or receives credit for all such Federal Reserve notes it returns to the original bank or sends to Washington for retirement.

Q. *Can Federal Reserve notes be issued with any kind of paper as collateral?*

A. No. The requirements regarding eligible paper are such as to reduce to a minimum the amount of paper of doubtful value pledged as collateral, and it cannot be issued for speculative purposes or run for more than 90 days, except paper issued for agricultural purposes or based on live stock, which may run for six months.

Q. *Is there any limit to the amount of Federal Reserve notes which can be issued?*

A. Yes. A Federal Reserve Bank must supply gold to the extent of 40% of the amount of Federal Reserve notes issued for its account. Therefore, the amount of notes which can be issued is dependent on the supply of gold in possession of the Federal Reserve Banks. The Federal Reserve Board has the power, however, to suspend this gold reserve requirement for a period of 30 days and to

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renew such suspension for periods not exceeding 15 days, subject to a graduated tax on the amount of the deficiency in the reserves.

Q. *What happened to all the National bank notes which were in circulation when the Federal Reserve Act became operative?*

A. In addition to the normal method of retirement, the act provided a means for retiring a portion of such notes through a provision giving authority to the Federal Reserve Banks to purchase the United States Government bonds securing the National bank notes, in amounts not to exceed $25,000,000 per annum, and to issue Federal Reserve Bank notes equal to the par value of such bonds. Notes issued for this purpose bear the name of the Federal Reserve Bank issuing them, while the Federal Reserve notes issued for commercial paper, etc., bear the number of the Federal Reserve Bank for whose account they were issued, but not the name of the Federal Reserve Bank, except in the seal imprint. Federal Reserve Bank notes in any denomination, including $1 and $2, can also be issued by Federal Reserve Banks, secured by United States Certificates of Indebtedness or one-year gold notes. A summary of the different kinds of paper money in circulation on October 1, 1920, follows:

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Federal Reserve Notes.....	$3,278,000,000	64.69%
Federal Reserve Bank Notes.	230,000,000	4.54
U. S. Gold and Silver Certificates.....	510,000,000	10.07
National Bank Notes.....	710,000,000	14.01
"Greenbacks".....	337,388,247	6.66
"Treasury Notes of 1890"...	1,642,138	.03
	$5,067,030,385	100.00%

It will be seen from the foregoing that more than 64% of the paper currency at present outstanding is subject to automatic retirement when not needed and that only 14% is now represented by National bank notes.

Q. *What are the "greenbacks" listed above?*

A. These were United States Treasury notes issued during the Civil War and are payable in gold. A gold reserve fund of approximately 42% is now held against them.

Q. *Was not the old way of issuing bank notes more beneficial to the United States Government, as it could thereby sell its bonds bearing only 2% interest?*

A. Under the old system the United States Government was able to borrow its money at low rates of interest, but, as stated above, this method produced a form of currency which was not sufficiently elastic for the growing business of the country, and, while the Government is now paying higher interest on borrowed money, it is entitled to all the earnings of the Federal Reserve Banks in excess of 6% dividends on the stock of the Fed-

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eral Reserve Banks owned by the member banks, except the amount set aside as surplus.

Q. *Has a bank any other functions besides receiving money on deposit and paying checks drawn against it?*

A. Yes. One of the principal functions of a bank is in loaning out its funds to facilitate business operations. A bank also performs many other functions, such as collecting drafts and checks for its customers and correspondents in other cities, without which facilities it would be almost impossible to conduct business. It also supplies the machinery for collecting the money for our vast export business, and without the banks' help it would be exceedingly difficult for the farmer or the manufacturer to collect his money for the crops or products shipped to foreign countries.

Q. *How is this export business handled?*

A. The foreign exchange business is complicated and presents many phases, but possibly the reimbursement for a shipment of cotton from the United States to England will illustrate the transaction most simply. A cotton spinner in England, desiring to buy cotton in this country, first goes to a local cotton broker or import merchant in Liverpool and informs him of his special requirements. This broker gets in touch with exporters in this country by cable, secures a firm offer at a

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fixed price and submits it to the manufacturer. If they agree, the purchase is confirmed and the manufacturer then goes to his bank in Liverpool or London and establishes a credit for such amount as he estimates will be sufficient to cover the purchase he is about to make. As a rule the reimbursement is 60 days' sight drafts on English banks, such drafts being drawn in Pounds Sterling, which is the English currency.

The exporter or shipper of cotton in the United States must secure United States currency for such shipment so that settlement can be made with the farmer who could not use the English currency. The exporter therefore sells the 60-day English drafts to some bank in New York, New Orleans, Boston or Philadelphia, or he may sell to a local bank and the local bank sell to one of the banks in the larger cities.

So far the transaction is comparatively simple, but now come the phases which require expert knowledge, foresight and sound judgment. These drafts carry no interest and the sixty or ninety days they have to run only begins from the date they are accepted by the English bank, so that the American bank when purchasing them must take into consideration the time the drafts will be in transit before acceptance, as well as the time to run after that date in order to collect interest during the time it has the money invested. It must also estimate what the exchange rate between

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English and United States currency will be at the maturity, so that the English money, when converted into dollars, will be sufficient to repay the original dollars invested as well as the interest thereon. While these are the principles on which the transactions are based, they are much more simple in actual practice, as the drafts are usually sold in London by the American banks as soon as they have been accepted or when exchange or discount rates are favorable.

The farmer does not know or care anything about all this intricate figuring and calculating, as he simply sells his cotton at so much per pound, but this must be gone through with and the machinery must be there to do it, or he could not get his money without great delay.

Q. *Why could not the local banks send the drafts direct to the English banks without making use of the banks in the larger cities?*

A. There are a number of reasons why the local banks are unable to do this, the chief of which are as follows:

(a) The local banks have not sufficient capital and deposits to await the maturity of any considerable amount of drafts, or even the time necessary to send them to Europe for acceptance, so it is to their advantage, as well as to that of the cotton grower, to handle a greater amount of drafts and turn

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them over quickly at a moderate profit. Even the largest banks in the United States have not sufficient resources to hold all of these drafts until maturity, and therefore the banks sell or discount such drafts in Europe at every favorable opportunity, so that they can be in a position to take care of the constantly increasing demands on them by the producers of raw materials in this country.

(b) These drafts are drawn by many people on a great many banks, and the credit and standing of the drawers, the drawees and foreign banks must be carefully looked into and watched, in order to prevent loss through fraud or failures. This requires a credit department and extensive system of credit reports which a small bank could not support.

(c) It requires the undivided attention of a highly trained expert to deal successfully in foreign exchange, and a small or even a moderate size bank could hardly afford to pay for the services of such a man.

Q. *If the United States had larger banks, would it be advantageous to exporters?*

A. A large bank should be in position to command better facilities and operate more economically, with resultant good to business generally.

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Q. *Apparently the foreign exchange business is concentrated in a comparatively few large banks; therefore, can it be classified as part of the general banking business of the United States?*

A. While a comparatively small percentage of banks deal directly with the European banks, there are but few banks in the United States which do not have transactions that are the result of exports or imports, and the larger banks are the channels through which these transactions ultimately find their way to foreign countries.

Q. *Is there any special benefit in selling our crops and products to foreign countries?*

A. The more we can sell to foreign countries at a profit, the greater becomes the wealth of this country, because we are getting "the other man's money"; whereas, when products are sold for consumption in this country, it is as if we took money out of one pocket and put it in another.

Q. *Is the character of the business transacted by each bank the same?*

A. While the principles of banking are the same the world over, the character of the business transacted varies greatly according to the business of the community which the bank serves. A bank in a crop-growing district will lend money to the farmer from the time the ground is broken until

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the crop is harvested, when most of its loans are paid and the bank is obliged to find other outlets for making loans, until the planting season again comes around. The same condition exists in the lumber districts from the time the logs are cut until they are sold as finished lumber, as it does also in the mill districts or the dry goods districts, or canneries, and, in fact, in almost every industrial district which has its season or seasons. And during part of the time the bank must stand ready to advance money to sound industries, while at other periods the money is repaid and accumulates in the banks until the next season opens. If a bank is fortunately situated in a community that has a number of different kinds of industries, with different seasons, it can profitably keep its money employed locally, but if not it must find other means of earning income.

Q. *When a bank is situated where there are industries which employ its money only part of the year, what does the bank do with its idle funds during the remainder of the year?*

A. There are several ways in which a bank can employ idle funds at such times. It may deposit the funds with other banks in larger cities, where the demands for money are more varied, and receive interest on the money so deposited. This is a convenient and safe method and is followed by many for the profitable use of a part of their funds.

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Other banks may purchase railroad or other bonds for the purpose of selling them when the money is again required, but this method is not so popular for the reason that there is always the chance that the market value of the bonds may fall off for some reason just at the time when the money is needed, and the expected income be depleted. On the other hand, the bonds may increase in value with greater profit than was anticipated. Probably one of the most popular methods is the purchase of two three, and four months Bills Receivable or Acceptances of firms and corporations, of known standing, but who are unable to borrow their full requirements from the banks where they are located, for the reason that a bank must keep itself in position to accommodate all worthy customers and not lend an excessive amount to any one person.

Q. *Is the purchase of notes and acceptances good business for a bank?*

A. When conducted in a conservative manner, this is very desirable business for a bank, as a bank is not only reasonably sure of getting back its money when needed, but in advancing money to sound industries it assists the general business of the whole country. Business is founded on confidence, and, without it, practically no business could be conducted. Therefore, the paper of an individual, firm, or corporation that is known to meet obligations promptly usually finds a ready

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market, and bank and general business both are benefited.

Q. *Is it desirable for a bank to lend money to its depositors?*

A. It is desirable, when loans are properly secured, and furthermore, one of the purposes of a bank is to assist and promote the transaction of business, and its depositors should have preference over those who are not depositors.

Q. *Should a bank lend money except on collateral?*

A. Theoretically, a bank never lends money unless there is some kind of collateral or means of repayment, although the collateral may not always be in its possession. That is, a bank should not and would not lend money unless there is an equity of some kind which will insure the return of the money to the bank, but whether the actual collateral shall be deposited with the bank depends largely on the character of the person or organization making the loan, and the nature of the business or the purpose for which the money is borrowed. The officers and directors of a bank must know not only the character and reliability of the prospective borrower, but, when actual collateral is not deposited, should also know the purposes for which the money is borrowed, the soundness of the business, and the ability of the borrower to pay on maturity.

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Q. *What are the chief features that a bank must consider when called upon to make a loan?*

A. A bank must look first to the safety of the loan, whether it will be paid promptly upon maturity, and whether the collateral securing it will have a ready market in case of default at maturity. Next, whether, in view of the maturities of its other loans and the probable withdrawal of deposits at certain seasons of the year, it can lend the money for the period desired by the borrower. Next, whether, in advancing the full loan desired, it will necessitate a refusal to other depositors who may possibly desire accommodation during the life of such loan.

Q. *A bank, therefore, cannot always make a loan, even though the collateral be of best quality and the borrower of highest standing?*

A. No. A bank must keep a certain part of its assets in very liquid form and must arrange the maturity of its outstanding loans so that the money will flow into the bank when needed, and it must be prepared to take equal care of all of its customers when occasions arise. Therefore, a prospective borrower may not be accommodated, even though his proposition or collateral may be of the highest quality, if the bank thinks that it would be unwise to lend more money at such time.

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Q. *It is necessary, then, for a banker not only to keep close watch on his business of the day, but also to look well into the future?*

A. Yes. A banker must be a keen observer and be able to foresee not only future conditions regarding the transactions of his own bank, but general business conditions as well. To be successful he must be a man of high mentality and broad experience, with a general knowledge of all kinds and conditions of business.

Q. *Does a banker occupy a higher position of trust than the average business man?*

A. From the nature of his business he must be of the highest standing, or his success will be limited. He may be an honest man, yet if he is lacking in business judgment, people will not entrust their funds to his care, and he will not be successful. On the other hand, he may be a most competent business man, but if people feel that he is weak or too sharp he will be even less successful than the foregoing type of banker. A banker, therefore, must not only be honest but he must also keep his bank in such condition that the money deposited therein can be promptly returned when required.

Q. *In New York City, some banks are known as Wall Street banks and some as purely commercial banks. What is the difference between the two?*

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A. Here again the locality in a measure determines the character of the bank's business. Banks located around the financial centre are generally spoken of as Wall Street banks, because the bankers and brokers desiring to borrow money on stocks and bonds usually apply to them, as these banks are more convenient than others located in other parts of the city. The other banks are generally known as commercial banks, for the reason that they lend money almost exclusively to merchants on their notes or other collateral.

Q. *Do Wall Street banks lend only to bankers and brokers on stocks and bonds?*

A. By no means, as they lend very largely to merchants and various business enterprises; in fact, the greater part of their business and more regular or steady income comes from the latter class of borrowers. The so-called Wall Street banks are also the principal channels through which the foreign exchange in New York is handled and a very considerable portion of their funds are devoted to that class of business, which involves the movement of cotton, grain, beef, etc. For several years, one of the largest of these institutions has each year employed more money in the purchase of foreign exchange than in all of its loans during the year. As stated previously, the foreign exchange represents the export of cotton,

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grain, beef and other commodities from the United States to foreign countries.

Q. *If loans to merchants and business enterprises are more profitable, why do these banks lend money to bankers and brokers?*

A. There are several reasons why banks lend a portion of their funds to bankers and brokers on what are known as "Street" loans. In the first place, there is no class of loan where the value of the collateral can be so readily watched as that of "Street" loans, or which can be more quickly converted into cash. Most of the banks that put out money in such loans have large deposits and it is no uncommon thing for them to have many millions of dollars withdrawn from them in a single day, and the "Street" loans afford a ready means for obtaining the money with which to meet these drafts without borrowing from the Federal Reserve Bank.

Then again, the lending of money on stocks and bonds is just as important for the welfare of the country as the lending of money by other banks to the farmer to raise his crops and the lumberman to cut his logs. All business must be financed in one way or another. The farmer needs the money to grow his crops; the railroads require money to purchase equipment to transport the crops. The farmer needs his money every year; a railroad may need money only once in several years, but

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it needs very large sums, so it goes to the bankers and they in turn borrow the money until such time as the securities of that road can be sold and distributed to permanent investors. Both kinds of business are equally important for the general good and progress of the country. Where would this country be without the farmers? But where would the farmers be without the railroads? Therefore, if the Wall Street banks are to do their duty to the farmer, the lumberman, the manufacturer and the country generally, they must take care of the business of their locality, part of which is to assist bankers in supplying money to finance the development of the country.

Q. *But is there no speculation in Wall Street?*

A. Yes. There is speculation in stocks and bonds in Wall Street, just as there is speculation in cotton, wheat, cattle, timber land, and every other commodity man deals in, but the sound business of procuring money for developing the industries of the country predominates, or speculation would die a natural death—just as there would be no speculation in cotton if no cotton were raised.

Q. *Is the cash for Wall Street operations supplied entirely by New York City banks?*

A. No. A very considerable part of the money lent on stocks and bonds in the Wall Street district

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is sent there for that purpose by banks all over the United States, particularly when the rates for money are higher in New York than the local rates and when local requirements for bank money are slack.

Q. *What is the reason for some banks having so much greater deposits than others when located in the same city and even the same neighborhood?*

A. The popular thought on this subject is that the large banks are the result of consolidations or mergers. While this, in a measure, is the visible cause of the growth of many of the larger banks, it is not the true reason for their large deposits. The actual causes are many and lie below the surface and each is essential to the success of a large bank.

The first essential is *confidence.* A man or a group of men might put a dozen banks together, which, at the time of consolidation, would have aggregate deposits larger than the biggest bank in the world, yet, if the depositors did not have confidence in the management of the bank, its deposits would soon melt away. Of course, the bank would still have its capital and surplus, but these would be of no use without business, and there would be nothing left for the bank to do but close up.

This same condition can be illustrated in every walk of life. Suppose there are two grocery stores

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in the same neighborhood. Suddenly people begin to suspect that one of the stores is selling inferior goods or is a little short in weight, or in some unknown way is not giving as full value as the other store, or is not polite to its customers. In a very short time, that store will lose its trade, or all except perhaps that of a few customers who are bad pay and only keep on trading there because the other store will not allow them credit. So it is with a bank—if the depositors lose confidence in its management, the deposits dwindle quickly and no amount of consolidation will bring them back. Therefore, *confidence* is absolutely necessary to hold the deposits of a large bank.

Another important item is *service*. Nearly all banks have the confidence of the people, or they would cease to exist, but a bank must also give good service, or some other bank giving better service will get the business. Good service means a minimum amount of clerical mistakes, prompt attention to business entrusted to its care, the assembling of various data and information for the use of its customers, courtesy to depositors and all others having dealings with the bank, and the operation of special departments or transactions to meet the requirements of the depositors of its locality.

Of course, the locality and the natural laws of commerce are responsible for the amount of deposits in any particular city, and, as a rule, the

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largest cities have the largest business and, consequently, the largest deposits, but the division of their deposits among the banks is governed by the bank's particular locality in the city, its history, the public's confidence, its service, and in the interest displayed by its directors, officers and depositors in constantly seeking new business of the right kind.

Q. *From the previous answer it is inferred that the depositors themselves frequently increase the business of the bank by bringing in new customers which would indicate that they desire the business of the bank to grow. Is this so?*

A. Yes. A pleased customer is the best kind of advertising. This is a day of big things, and people like to be connected with big things, and a bank which is growing attracts a great deal more business than a bank whose business remains stationary. Then also, as a bank increases in size, the margin of safety also increases and a depositor wants safety above all else.

Q. In what manner does the safety increase? If the deposits increase does not the percentage of capital and surplus to the total deposits decrease, with corresponding reduction in the margin of safety?

A. In one sense this would be so, except that banks usually keep adding to their surplus each year, which tends to maintain the percentage on

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about the same basis. Then again, banks are continually increasing their capital when there is a considerable increase in deposits, but the particular point of safety has reference to the bank's loans and investments.

Sometimes, with the greatest care, a loan or investment will go wrong and a bank may have to wait a considerable time for its money, or possibly lose some of it. Suppose, therefore, that a bank with deposits of one hundred thousand dollars desires to invest some of its money in a railroad bond. As a rule, these bonds are issued in denominations of only one thousand dollars each, so that in buying one of these bonds the bank would be obliged to invest an amount equal to one per cent. of its deposits.

On the other hand, one per cent. of the deposits of a bank of one hundred million deposits would be one million dollars, and such a bank could purchase that many bonds and be on the same basis relatively as the small bank. A large bank, therefore, instead of putting so much money in one investment, would probably distribute the amount over twenty or more different kinds of bonds to the extent of fifty thousand dollars each, so that if one kind went wrong the loss would represent only one-twentieth of one per cent. of the investment, instead of one per cent., as would be the case with a small bank.

It should not be construed from this or other

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references to small banks that they are unsafe; the examples are given merely to illustrate the reasons for the existence of large banks and why individuals and corporations having large sums of money to deposit seek the larger rather than the smaller banks.

All banks strive to increase their business as much as possible, but no matter how high their standing and service, their size is dependent upon their location and the character of the business of their depositors.

For the general good of the country, small banks are necessary, and the size to which they can grow is governed by the laws of trade and commerce and proper management.

Q. *How does a trust company differ from a National bank?*

A. A trust company is chartered under the State laws, although many of them are members of the Federal Reserve System and enjoy the same privileges as the National banks. Before the passage of the Federal Reserve Act, trust companies could do many things a National bank could not do, but now the Federal Reserve Board may permit a National bank to exercise all the functions granted to trust companies by the laws of the State in which the National bank is located.

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Q. *What are these additional functions which before were only permitted to trust companies?*

A. The principal functions were those of acting as executor and trustee, either under a will or under a voluntary trust of the living, where a person wants to make the principal and income secure for themselves or some other person; the acting of trustee under corporate mortgages where bonds, notes, etc., are issued for a corporation; acting as agent for bondholders' or stockholders' protective committees, and in consolidations, liquidations, reorganizations, rights to subscribe to new stock. exchange of securities, escrow agreements and bond registrations; acting as transfer agent and registrar of the stock of a corporation.

Q. *Do banks and trust companies hold securities for people only under wills or trusts?*

A. No; a great many securities are held in custody for the customers of a bank or trust company, because they prefer to have the institution collect their income for them; prepare their income tax returns, and generally relieve them of the details of looking after their affairs.

Q. *Will not an estate receive better attention if an individual is made an executor instead of a bank or trust company?*

A. Not under ordinary circumstances. If the trust department of a bank or trust company is

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properly organized, it will carefully review and watch the securities in which the money entrusted to it is invested, and is usually better informed on the values than a person not especially trained to understand such values.

Furthermore, the capital and surplus of the institution stands as a protection against fraud, while there are far too many cases on record where an individual, acting as executor, has misappropriated the funds of an estate, and nothing could be recovered, because the executor himself had nothing left.

Q. *Can an individual and bank or trust company be made joint executors?*

A. Yes. An individual and an institution can act jointly as executors and trustees and where there is some business to carry on, or some assets of a particular nature to liquidate, it is frequently advantageous to have such joint executors.

Q. *Why is a trustee appointed under a corporate mortgage?*

A. Such trustee is appointed to see that the covenants of the mortgage, under which the bonds or notes are issued, are properly lived up to by the corporation; that proper insurance is carried; that the equipment is properly maintained, etc., and to proceed against the corporation in the event of defaults.

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Q. *Does the corporate trustee also pay the bonds and coupons upon the issues for which it is trustee?*

A. Acting as paying agent for the corporation it usually does, but not always.

Q. *If the corporation itself can pay the coupons and bonds why does it not do so?*

A. In most cases the coupons come due only twice a year, and it would throw an undue burden on the clerical force of the corporation at such times, or a special force would be required which might not have much to do the remainder of the time. In addition, there is considerable technical knowledge necessary with respect to ownership certificates and income tax. There is also much more latitude for dishonesty if a corporation pays its own coupons, unless it has a sufficient number of issues to make payments on a large scale. Bonds usually fall due in large aggregate amounts, and, in addition to the lack of a trained clerical force, there is great risk to the corporation in handling such large amounts of negotiable securities.

Q. *Why do banks and trust companies act as transfer agent for corporations, and just what is a transfer agent?*

A. A corporation issues its stock in the name of an individual or corporation. When a person desires to sell the stock he endorses on the back of the certificate and appoints some one to transfer

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it out of his name on the books of the corporation. The transfer agent does this and issues a new certificate in the name of the purchaser, or whomever he may designate.

The reason why banks and trust companies usually act as transfer agent is because of the large amount of legal and technical knowledge required to pass on the validity of transfers where the owner of the stock has died, and for various other reasons out of the ordinary. One trained expert in a bank or trust company can pass on the transactions for any number of corporations, whereas if the corporations transferred their own stock, each would need a trained expert.

Q. *What is a discount bank?*

A. A bank of discount is organized primarily to trade in foreign and domestic bills of exchange, to create a current market for them and to facilitate the business of exports and imports. If it were not for the large discount market in London, the banks of the United States would have difficulty in handling anything like the amount of cotton and grain bills they now take care of. There are very few discount companies in the United States, but an increase in the number would help the business of the country.

Q. *What is an acceptance company?*

A. An acceptance company assists in financing

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various kinds of business by lending its credit, and providing a broader market for paper and, usually, a lower rate of interest than if a merchant borrowed direct.

Q. *How is this done?*

A. A merchant buys some goods and wants to borrow money until he can resell the goods. He goes to the acceptance company, which carefully investigates his affairs and perhaps finally grants him a line of credit of $100,000. When the merchant wants to pay for his goods he draws a sixty or ninety day draft on the acceptance company for the amount of money he requires, which is accepted by the acceptance company. The merchant then has the acceptance which bears the name of the acceptance company, and if he has arranged to do so he can use it direct with the person from whom he purchased the goods, or he can sell it to his bank or sell it in the open market, as the case may be.

Q. *Does he not have to pay anything to the acceptance company for doing this?*

A. Yes. He pays the acceptance company a commission for its services, but the commission he pays, plus the rate of discount such an acceptance commands, is less than he would be obliged to pay on his note without the endorsement of the acceptance company.

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Q. *Why is the interest, plus the commission, less than the interest would be on his individual note?*

A. The acceptance is two-name paper, and, in addition to the drawer's responsibility, has back of it the credit of the acceptance company.

Q. *Can National banks and trust companies accept drafts in the same manner?*

A. Yes. Banks and trust companies can and do accept up to limits prescribed by law, and most of the acceptance business of the country is done by them.

Commercial letters of credit are a form of acceptance. A buyer in the United States wants to purchase some rubber in South America. He goes to his bank and arranges a credit for the amount of the purchase and is granted a letter of credit. He makes his purchase and has his correspondent in South America draw against the bank which has issued him the letter of credit, with documents and bills of lading attached to the draft.

Q. *Does the purchaser have to pay, or put up collateral, when he takes out the letter of credit?*

A. That all depends on the credit standing of the purchaser. If he carries an account and is rated well he may not have to pay it until the draft is due, but if he cannot satisfy the bank of his solvency, or is weak financially, he must furnish cash or security for at least the difference between

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the amount of the draft and what the commodity purchased will bring under a forced sale.

Q. *Is there much risk attached to this class of business?*

A. This class of business requires a force of men, not only capable of watching the credit of the persons to whom the letters of credit are issued, but also having a thorough knowledge of the market values of all kinds of commodities. With reasonable care, however, the losses are very slight.

Q. *What is a Travelers Letter of Credit?*

A. A Travelers Letter of Credit is a document issued by a bank, trust company or banker, authorizing a correspondent in a foreign country to pay the person in whose favor the credit runs a specified amount, usually in some foreign currency. The correspondent charges the issuing bank with the amount it pays out in the currency called for in the Letter of Credit and upon arrival of advice of such payment the issuing bank converts the amount into dollars at the current rate of exchange and charges the amount against its customer. In many cases the customer pays for the letter of credit when it is issued at the rate of exchange at such time, and the issuing bank takes the risk of profit or loss in exchange when items are presented for payment. The bank, however, always knows its exchange position and can usu-

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ally buy to cover without loss before such items are presented for payment.

Q. *What are Travelers Checks and how do they differ from Travelers Letters of Credit?*

A. Travelers Checks are generally issued in fixed denominations of $10, $20, $50, and $100, some payable in foreign currencies at fixed rates of exchange, and some payable only in dollars. The person purchasing them signs all of the checks at the time of purchase in the place provided, and, as a means of identification, signs again in the presence of the party cashing the check. A Travelers Letter of Credit may be made out for any amount, and is more frequently used where large sums are to be expended.

Q. *Travelers Letters of Credit and Checks provide for payment in foreign countries when presented in person, but how can money be sent to a foreign country without leaving the United States?*

A. A person could, of course, send his personal check on his regular bank, but in most cases this would not be satisfactory, as both the person and the bank might be unknown abroad, and, besides, the question of exchange would be a factor. Banks doing a foreign exchange business have accounts with many correspondents in foreign countries, just as foreign banks carry deposit accounts in the United States. If a person wants to send money

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to Europe he usually goes to his bank and buys a draft payable in the foreign country. If the local bank has no foreign correspondent it applies to one of the banks doing an international business and obtains the draft from it. Of course, if haste is required, the whole transaction can be accomplished through the banks by cable, and a tremendous amount of such business is carried on each day.

Q. *What is a Federal Reserve Bank?*

A. Under the Federal Reserve Act of 1913 the United States was divided into twelve districts and each district has a Federal Reserve Bank, with one or more branches if desired.

Q. *Do Federal Reserve Banks take deposits from individuals?*

A. No. The Federal Reserve Bank can take deposits only from member banks and trust companies, foreign banks, foreign governments and certain United States Government funds. It can also take deposits from non-member banks for specific purposes only.

Q. *What are the functions of Federal Reserve Banks?*

A. The principal functions are:

(a) The centralization and regulation, under Governmental control, of the gold reserves of the United States, which for-

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merly were scattered through some thirty thousand banks of the country, with greater opportunities to ship it to foreign countries or dispose of it at pleasure. The centralization and control of the gold is in the best interests of the country as a whole and makes the gold more readily available for credit purposes.

(b) The means by which the currency of the country is automatically expanded and contracted to meet business requirements, as previously explained.

(c) To facilitate business by acting as a clearing house for the collection of checks, drafts, etc.

(d) To act as a balance wheel in regulating credit expansion in excess of the amount necessary and safe for the good of the country.

(e) To act as a medium through which the United States Government can distribute its borrowings when in need of funds.

(f) To purchase in the open market, or from other Federal Reserve Banks, commercial bills of exchange, bankers' acceptances, etc., which would tend to preserve equilibrium between localities where money was plentiful and where it was scarce.

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Q. *Can the deposits of member banks and trust companies with Federal Reserve Banks be treated as reserves for their deposits?*

A. Yes.

Q. *What reserves are banks and trust companies required to keep?*

A. On time deposits banks and trust companies which are members of the Federal Reserve System are required to keep 3% of the deposits, while on demand deposits the amount varies according to the location of the bank. Country banks are required to hold 7% reserves, while banks in reserve cities are obliged to hold 10%, and in central reserve cities 13%. As a result of greater flexibility under the Federal Reserve law in obtaining funds in times when there are heavy demands for money, the banks can operate more safely with the smaller reserves than they could formerly with the higher reserves required under the old law.

Q. *Are Federal Reserve Banks also obliged to carry reserves to protect deposits with them?*

A. Yes. Federal Reserve Banks must carry reserves of 35% of deposits in gold or lawful money. Lawful money is gold or silver, or certificates issued therefor, and legal tender notes.

Q. *What is the purpose of having reserves?*

A. A bank must invest the money deposited with it or it could not pay operating expenses or

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interest on deposits, and the money would not be available for loans to business enterprises, to move crops, etc. On the other hand, a bank must not lend all of its deposits, or it would not be in a position to meet any unusual withdrawal of funds. Consequently, the law requires a certain percentage of the funds deposited shall be held in a reserve fund and the reserves of banks and trust companies in the Federal Reserve System are held by the Federal Reserve Banks.

Q. *Suppose that an unusual amount should be withdrawn from a bank so that its reserve fund would be depleted below the amount required by law; what would happen?*

A. The member bank or trust company would rediscount with the Federal Reserve Bank sufficient eligible commercial paper to restore its reserves.

Q. *Suppose there were a number of unusual withdrawals and the bank had no more commercial paper it could rediscount with the Federal Reserve Bank and no bonds upon which it could borrow money from the Federal Reserve Bank; what would it do then?*

A. In an extreme case of this kind, assuming that the bank did not have other assets upon which it could realize in the immediate future, it would be obliged to suspend payment.

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Q. *If a bank suspended payment, would the depositors lose money?*

A. A bank might be obliged to suspend if it were loaded up with too many slow loans and paper which was not eligible, even if its assets ultimately realized one hundred cents on the dollar. As extra security, however, the Federal law and many of the State laws make the stockholders of banks and trust companies liable for an additional amount of money equal to the amount of their stock ownership. Therefore, unless there were unusually bad judgment and management, the depositors would be reasonably safe, although there might be delay in receiving their money.

Q. *Who owns the stock of the Federal Reserve Banks?*

A. The stock of the Federal Reserve Banks is owned by banks and trust companies which are members of the Federal Reserve System.

Q. *If the stock of the Federal Reserve Banks is owned by banks and trust companies, how does the operation of the Federal Reserve System come under Governmental control?*

A. The policies and affairs of the twelve Federal Reserve Banks are under the general supervision of a Federal Reserve Board, located in Washington. This Board is composed of seven members, including the Secretary of the Treasury and the

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Comptroller of the Currency. The other five members are appointed by the President of the United States.

Q. *Would it be beneficial if the Government owned all of the banks, instead of controlling their operations through the Federal Reserve Board and Federal Reserve Banks?*

A. To accomplish the best results in any undertaking there must be the personal incentive for profit, which is entirely lacking in government ownership. To produce profit a bank must be run safely, give good service, and please its customers, and, therefore, should reach its highest development and render the greatest public service when privately owned. If a bank makes money, the customers of the bank and the general public can share in its prosperity by becoming stockholders. A bank which has its stock owned largely by its customers and employees is in a most favorable position.

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Econ 4

Federal Taxes on Inco and Profits

Guaranty Trust Company
of New York

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Federal Taxes on Income and Profits

Imposed by the Revenue Act of 1918

Guaranty Trust Company of New York

140 Broadway

FIFTH AVENUE OFFICE
Fifth Avenue and 43rd Street

MADISON AVENUE OFFICE
Madison Avenue and 60th Street

LONDON OFFICES
32 Lombard Street, E.C.
5 Lower Grosvenor Pl., S. W.

LIVERPOOL OFFICE
27 Cotton Exchange Buildings

PARIS OFFICE
1 & 3 Rue des Italiens

HAVRE OFFICE
122 Boulevard Strasbourg

BRUSSELS OFFICE
158 Rue Royale

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Foreword

THIS booklet contains a summary of important rulings of the Treasury Department relating to income and excess profits taxes, imposed under the Revenue Act of 1918. It has not been possible to cover all regulations which have been issued by the Department, but an effort has been made to cover those which are of the most general importance, laying special emphasis on those parts of the regulations which are applicable to the taxable year 1919. Much care has been used in the compilation of this booklet and although we cannot insure the accuracy of all statements, we believe them to be correct.

We have omitted reference to withholding of tax and information at the source, and the use of ownership certificates, these subjects having been treated in a separate booklet which we have prepared.

In the discussion of the excess profits tax, we have also omitted reference, so far as possible, to regulations dealing with the war profits tax, inasmuch as this tax is applicable only to corporations which report on the basis of a fiscal year in 1919, ending other than December 31, 1919, and to corporations which derive during 1919 more than $10,000 from Government contracts. As the majority of the corporations under the first class have already prepared their returns, and as the number of corporations deriving income from Government contracts, is comparatively few, we have not deemed it necessary to devote the amount of space which would be necessary to describe the computation of tax and the determination of income in such cases.

Guaranty Trust Company of New York

January 23, 1920

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PART I. INCOME TAX—IMPOSITION OF TAX

RATES OF TAX

The statute imposes an income tax upon individuals, including a normal tax and a surtax. The tax is upon net income, after deducting from gross income, the allowable deductions.

Normal Tax.—For the calendar year 1919 and subsequent years the normal tax on individual citizens or residents of the United States is 4 per centum upon the first $4,000 in excess of allowable deductions and credits and 8 per centum upon the excess over that amount. The lower rate on the first $4,000 applies to each separate individual, whether married or unmarried, and should not be confused with the joint exemption granted married persons.

In the case of a nonresident alien individual the entire net income from sources within the United States, less any allowable deductions and credits, is subject to the normal tax at the rate of 8 per centum for 1919 and subsequent years.

Surtax.—In addition to the normal tax, a surtax is imposed upon the net income of every individual, resident or nonresident, in excess of $5,000. In determining the taxable net income for the purpose of the surtax the credits provided by Section 216 of the statute are not applicable.

The chart on page 2 shows the rates of normal tax and surtax and the total tax on citizens and residents of the United States on net incomes of specified amounts. The surtax for any amount of net income not shown in the chart is computed by adding to the total surtax for the largest amount shown which is less than the income, the surtax upon the excess over that amount at the rate indicated in the table.

Surtax on Sale of Mineral Deposits.—Where the taxpayer by prospecting and locating claims, or by exploring and discovering undeveloped claims, has demonstrated the principal value of mines, oil or gas wells, which prior to his efforts had a merely nominal value, the portion of the surtax attributable to a

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INCOME TAX CHART

Based on the Revenue Act of 1918

(Chart shows the tax payable for 1919 and subsequent years by a married person, but does not take cognizance of the $200 exemption for each dependent child)

**Net Income	Rate of Normal Tax	Rate of Surtax	Amount Subject to Surtax Between Change of Rates	Amt. of Normal Tax	Amt. of Surtax on Instal.	Total* Surtax	Total Tax
$ 3,000	4%			40			40
4,000	4%			80			80
5,000	4%			120			120
6,000	4%	1%	5,000 to 6,000	160	10	10	170
8,000	8%	2%	6,000 to 8,000	320	40	50	370
10,000	8%	3%	8,000 to 10,000	480	60	110	590
12,000	8%	4%	10,000 to 12,000	640	80	190	830
14,000	8%	5%	12,000 to 14,000	800	100	290	1,090
16,000	8%	6%	14,000 to 16,000	960	120	410	1,370
18,000	8%	7%	16,000 to 18,000	1,120	140	550	1,670
20,000	8%	8%	18,000 to 20,000	1,280	160	710	1,990
22,000	8%	9%	20,000 to 22,000	1,440	180	890	2,330
24,000	8%	10%	22,000 to 24,000	1,600	200	1,090	2,690
26,000	8%	11%	24,000 to 26,000	1,760	220	1,310	3,070
28,000	8%	12%	26,000 to 28,000	1,920	240	1,550	3,470
30,000	8%	13%	28,000 to 30,000	2,080	260	1,810	3,890
32,000	8%	14%	30,000 to 32,000	2,240	280	2,090	4,330
34,000	8%	15%	32,000 to 34,000	2,400	300	2,390	4,790
36,000	8%	16%	34,000 to 36,000	2,560	320	2,710	5,270
38,000	8%	17%	36,000 to 38,000	2,720	340	3,050	5,770
40,000	8%	18%	38,000 to 40,000	2,880	360	3,410	6,290
42,000	8%	19%	40,000 to 42,000	3,040	380	3,790	6,830
44,000	8%	20%	42,000 to 44,000	3,200	400	4,190	7,390
46,000	8%	21%	44,000 to 46,000	3,360	420	4,610	7,970
48,000	8%	22%	46,000 to 48,000	3,520	440	5,050	8,570
50,000	8%	23%	48,000 to 50,000	3,680	460	5,510	9,190
52,000	8%	24%	50,000 to 52,000	3,840	480	5,990	9,830
54,000	8%	25%	52,000 to 54,000	4,000	500	6,490	10,490
56,000	8%	26%	54,000 to 56,000	4,160	520	7,010	11,170
58,000	8%	27%	56,000 to 58,000	4,320	540	7,550	11,870
60,000	8%	28%	58,000 to 60,000	4,480	560	8,110	12,590
62,000	8%	29%	60,000 to 62,000	4,640	580	8,690	13,330
64,000	8%	30%	62,000 to 64,000	4,800	600	9,290	14,090
66,000	8%	31%	64,000 to 66,000	4,960	620	9,910	14,870
68,000	8%	32%	66,000 to 68,000	5,120	640	10,550	15,670
70,000	8%	33%	68,000 to 70,000	5,280	660	11,210	16,490
72,000	8%	34%	70,000 to 72,000	5,440	680	11,890	17,330
74,000	8%	35%	72,000 to 74,000	5,600	700	12,590	18,190
76,000	8%	36%	74,000 to 76,000	5,760	720	13,310	19,070
78,000	8%	37%	76,000 to 78,000	5,920	740	14,050	19,970
80,000	8%	38%	78,000 to 80,000	6,080	760	14,810	20,890
82,000	8%	39%	80,000 to 82,000	6,240	780	15,590	21,830
84,000	8%	40%	82,000 to 84,000	6,400	800	16,390	22,790
86,000	8%	41%	84,000 to 86,000	6,560	820	17,210	23,770
88,000	8%	42%	86,000 to 88,000	6,720	840	18,050	24,770
90,000	8%	43%	88,000 to 90,000	6,880	860	18,910	25,790
92,000	8%	44%	90,000 to 92,000	7,040	880	19,790	26,830
94,000	8%	45%	92,000 to 94,000	7,200	900	20,690	27,890
96,000	8%	46%	94,000 to 96,000	7,360	920	21,610	28,970
98,000	8%	47%	96,000 to 98,000	7,520	940	22,550	30,070
100,000	8%	48%	98,000 to 100,000	7,680	960	23,510	31,190
150,000	8%	52%	100,000 to 150,000	11,680	26,000	49,510	61,190
200,000	8%	56%	150,000 to 200,000	15,680	28,000	77,510	93,190
300,000	8%	60%	200,000 to 300,000	23,680	60,000	137,510	161,190
500,000	8%	63%	300,000 to 500,000	39,680	126,000	263,510	303,190
1,000,000	8%	64%	500,000 to 1,000,000	79,680	320,000	583,510	663,190
over 1,000,000	8%	65%					

* Total Surtax is the total of the installments for the income considered.

** Exemption $2,000. No allowance is made for credit for dividends or interest on Liberty Bonds, if any, included in net income.

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sale of such property or of the taxpayer's interest therein shall not exceed 20 per centum of the selling price. Exploration work alone without discovery is not sufficient to bring a case within this provision. Shares of stock in a corporation owning mines, oil or gas wells do not constitute an interest in such property. To determine the application of this provision to a particular case, the taxpayer should first compute the surtax in the ordinary way upon his net income, including his net income from any such sale. The proportion of the surtax indicated by the ratio which the taxpayer's net income from the sale of the property bears to his total net income is the portion of the surtax attributable to such sale, and if it exceeds 20 per centum of the selling price such portion of the surtax shall be reduced to that amount.

Profits of Corporations Taxable to Stockholders.—Section 220 of the statute provides that when a domestic or foreign corporation permits its profits to accumulate for the purpose of preventing the imposition of the surtax upon such income if distributed to its stockholders, it shall not be subject to the income tax as a corporation, but its stockholders shall be subject to tax in the same manner as the stockholders of a personal service corporation, except that the war profits and excess profits taxes of the corporation shall first be deducted from its net income before computing the proportionate shares of the stockholders. If, upon the basis of a statement of profits submitted on request of the Commissioner or a collector, the Commissioner certifies that in his opinion the accumulation is unreasonable, the corporation and its stockholders shall make their returns accordingly.

An accumulation of gains and profits is unreasonable if it is not required for the purpose of the business, considering all the circumstances of the case. No attempt can be made to enumerate all the ways in which gains and profits of a corporation may be accumulated for the reasonable needs of the business.

Undistributed income is considered to be properly accumulated if invested in increased inventories or additions to plant reasonably needed by the business. It is properly accumulated if retained for working capital required by the business or in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. In the case of a banking institution, the business of which is to receive and loan money, using capital, surplus and deposits for that purpose, undistributed income actually represented by loans or reasonably

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retained for future loans is not accumulated beyond the reasonable needs of the business. The nature of the investments of gains and profits is immaterial, if they are not in fact needed in the business. Thus, the fact that an unreasonable accumulation of profits is invested by the corporation in obligations of the United States does not remove such corporation from the provisions of Section 220.

Persons Liable to Tax.—Every citizen of the United States, wherever resident, is liable to the tax, even though he may have no assets within the United States and receives no income from sources therein. Every resident alien individual is liable to the tax, even though his income is wholly from sources outside the United States. Every nonresident alien individual is liable to the tax on his income from sources within the United States. Estates and trusts are also subject to the tax.*

Citizen Defined.—Every person born in the United States subject to its jurisdiction, or naturalized in the United States, is a citizen. When any naturalized citizen has left the United States and resided for two years in the foreign country from which he came, or for five years in any other foreign country, he is presumed to have lost his American citizenship; but this presumption does not apply to residence abroad while the United States is at war.

Nonresident Alien Individual Defined.—"Nonresident alien individual" means an individual other than a citizen of the United States whose residence is not within the United States. Any alien living in the United States who is not a mere transient, and has no definite intention with regard to his stay, is a resident for purposes of the income tax. The best evidence of his intention is afforded by the conduct, acts, and declarations of the alien. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. The fact that an alien's family is abroad does not necessarily indicate that he is a transient rather than a resident. An alien who enters this country intending to make his home in a foreign country as soon as he has accumulated a sum of money sufficient to provide for his journey abroad is to be considered a transient, provided his expectation in this regard may reasonably be fulfilled within a comparatively short time, considering the rate of his savings.

*See page 25

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Income Tax on Corporations.—An income tax is imposed upon the net income, after deducting credits, of all corporations, not expressly exempt under Section 231 of the law, at the rate of 10 per centum for the calendar year 1919 and subsequent years. The tax is imposed notwithstanding the fact that a domestic corporation has received no income from sources within the United States. On the other hand, a foreign corporation is taxed only on its net income from sources within the United States. Personal service corporations within the meaning of Section 200 of the law are not subject to taxation, but the individual stockholders thereof are taxed in the same manner as the members of partnerships and all the provisions of the law relating to partnerships and the members thereof, as far as practicable, apply to personal service corporations and the stockholders thereof. For definition of a personal service corporation, see page 22.

CREDITS

Individuals

For the purpose of imposing the normal tax, net income, as determined by deducting from gross income the allowable deductions, is first reduced by the sum of the allowable credits. These include:

(1) Dividends received from a corporation taxable upon its net income, or dividends from a personal service corporation paid out of earnings upon which income tax has been imposed;

(2) Interest not wholly exempt from tax received upon obligations of the United States and bonds of the War Finance Corporation;

(3) Personal exemption—

(a) In the case of single person, or married person not living with husband or wife, $1,000;

(b) In the case of married person living with husband or wife, or head of a family, $2,000;

(4) Exemption of $200 for each dependent person, other than husband or wife, under eighteen years of age or incapable of self-support because mentally or physically defective, receiving his chief support from the taxpayer.

Personal Exemption of Married Person.—In the case of a married man or a married woman the joint exemption replaces the individual exemption only if the man lives with his wife or the woman lives with her husband. In the absence of continuous actual residence together, whether or not a man or woman has a wife or husband living with him or her within the meaning of the

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statute must depend on the character of the separation. If the absence of either is only temporary, the additional exemption applies. The unavoidable absence of a wife or husband at a sanatorium or asylum on account of illness does not preclude claiming the exemption. If, however, the husband voluntarily and continuously makes his home at one place and the wife hers at another, they are not living together within the meaning of the statute, irrespective of their personal relations. The personal exemption may be divided between husband and wife in any proportion agreed upon by them. A resident alien with a wife residing abroad is not entitled to the joint exemption.

"Head of Family" Defined.—A "head of a family" is a person who actually supports and maintains in one household one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation. In the absence of continuous actual residence together, whether or not a person with dependent relatives is a head of a family within the meaning of the statute must depend on the character of the separation. If a father or a child or other dependent is temporarily away, the common home being still maintained, the additional exemption applies. Also, if a parent is obliged to maintain his dependent children with relatives or in a boarding house while he lives elsewhere, the additional exemption may still apply. If, however, without necessity the dependent continuously makes his home elsewhere, his benefactor is not the head of a family, irrespective of the question of support. A resident alien with children abroad is not the head of a family.

Credit for Dependents.—A credit of $200 is also allowed for each person (other than husband or wife), whether related to the the taxpayer or not and whether living with him or not, dependent upon and receiving his chief support from the taxpayer, provided the dependent is either (a) under eighteen or (b) incapable of self-support because mentally or physically defective. The credit is based upon actual financial dependency and not mere legal dependency. It may accrue to a taxpayer who is not the head of a family. But a father whose children receive half or more of their support from a trust fund or other separate source is not entitled to the credit.

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Date Determining Exemption.—The status of the taxpayer on the last day of his taxable year determines the amount of his credit for personal exemption and exemption for dependents. If an individual dies during the taxable year, his executor or administrator in making a return for him is entitled to claim his full personal exemption according to his status at the time of his death. If a husband or wife so dies and the joint personal exemption is used by the executor or administrator in making a return for the decedent, an undiminished personal exemption according to the status of the survivor at the end of the taxable year may be claimed in the survivor's return.

Credits to Trust or Beneficiary.—An estate or trust, where income is taxed to the fiduciary, is allowed the same credits against net income as a single person, including a personal exemption of $1,000, but no credit for dependents. In the case of an estate or trust taxed to the beneficiaries each beneficiary is allowed for the purpose of the normal tax, in addition to his individual credits, his proportionate share of such dividends from domestic and resident foreign corporations and of such interest not entirely exempt from tax upon obligations of the United States and bonds of the War Finance Corporation as are received by the estate or trust. Each beneficiary is entitled to but one personal exemption, no matter from how many trusts he may receive income.

Credits Allowed Partners and Stockholders of Personal Service Corporation.—In addition to the credits ordinarily allowed an individual*, a partner or stockholder of a personal service corporation is entitled to a credit against net income, for the purpose of the normal tax only, of his proportionate share of such dividends from corporations subject to tax and of such interest not entirely exempt from tax upon obligations of the United States and bonds of the War Finance Corporation as are received by the partnership or personal service corporation.

A stockholder of a personal service corporation is also entitled to credit, for the purpose of the normal tax, for amounts received in distribution of earnings of the corporation accumulated since February 28, 1913, and prior to January 1, 1918.

For allowance of credits to nonresident alien individuals and foreign corporations, see pages 8, 19 and 20.

*See page 5

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Corporations

The net income of a corporation, other than a personal service corporation, determined by subtracting from gross income the amount of the deductions defined in the law, is the net income upon which the excess profits tax is computed, but before the application of the income tax the following credits against net income are allowed:

(a) A specific credit of $2,000 (not allowed a foreign corporation);

(b) The amount of any war profits and excess profits tax assessed or to be assessed by the United States for the same taxable year;

(c) The amount of interest received upon obligations of the United States and bonds of the War Finance Corporation, which is subject to war profits and excess profits taxes.

For the purpose of the excess profits tax a corporation is not entitled to the foregoing credits.

Return for Period Less Than a Year.—Where a return is made for a period less than a year, as in the case of a corporation making its first return of income on the basis of a fiscal year, or as in the case of a corporation changing its accounting period, whether from calendar year to fiscal year, from fiscal year year to calendar year, or from one fiscal year to another fiscal year, the specific credit of $2,000 shall be reduced to such a proportion of the full credit as the number of months in the period for which the return is made bears to twelve months.

CORPORATIONS EXEMPT FROM TAX

The following organizations are exempt from tax under Section 231 of the Law:

(1) Labor, agricultural, or horticultural organizations;

(2) Mutual savings banks not having a capital stock represented by shares;

(3) Fraternal beneficiary societies, orders, or associations (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and (b) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

(4) Domestic building and loan associations and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

(5) Cemetery companies owned and operated exclusively for the benefit of their members;

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(6) Corporations organised and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual;

(7) Business leagues, chambers of commerce, or boards of trade, not organised for profit and no part of the net earnings of which inures to the benefit of any private stockholder or indidivual;

(8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare;

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private stockholder or member;

(10) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses;

(11) Farmers', fruit growers', or like associations, organized and operated as sales agents for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

(12) Corporations organized for the exclusive purpose of holding title to the property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title;

(13) Federal land banks and national farm-loan associations as provided in Section 26 of the Act approved July 17, 1916, entitled "An act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes";

(14) Personal service corporations.

Establishing Exemption.—In order to establish its exemption and be relieved of the necessity of filing returns of income and paying a tax, every organization claiming exemption, except personal service corporations, must file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it is organized, the sources of its income, and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private stockholder or individual, and, in general, all facts relating to its operation which affect its right to exemption. A copy of the charter or articles of incorporation and by-laws of the organization should

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be attached to the affidavit. Upon receipt of the affidavit and other papers the collector will inform the organization whether or not it is exempt, unless there is doubt as to the taxable status of the organization, in which case he will refer the affidavit and papers submitted, to the Commissioner for decision. Once an organization has established its right to exemption, no return need be made thereafter, and no further showing is required with respect to its status unless there is a change in the character of its organization or operations or the purpose for which originally created.

INSURANCE COMPANIES

Gross Income.—In general, the gross income of insurance companies consists of their total revenue from the operation of the business, together with their income from all other taxable sources. The term also includes net premiums, that is, gross premiums less returned premiums on policies cancelled and premiums on policies not taken, investment income, profits from the sale of assets, and all other gains, profits and income reported to state insurance departments, except income specifically exempt from tax. Premiums received by mutual marine insurance companies which are paid out for reinsurance, should be eliminated from gross income and the payments for reinsurance from disbursements. Deposit premiums on perpetual risks received and returned by fire insurance companies should be treated in like manner, as no reserve will be recognized covering liability for such deposits. The earnings on such deposits must be included in the investment income. A net decrease in reserve funds required by law within the taxable year must also be included in the gross income.

The income from business relating to a foreign country which is transacted by a United States branch or agency of a foreign insurance company, must be returned as gross income.

Life Insurance Companies.—A life insurance company should not include in gross income such portion of any actual premium received from any individual policyholder as is paid back or credited to or treated as an abatement of premium of such policyholder within the taxable year. "Paid back" means paid in cash. "Credited to" means held to the credit of, including dividends applied to pay renewal premiums, purchase additional paid-up insurance, or annuities, or to shorten the endowment or premium-paying period. It does not include dividends provisionally ascer-

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tained and apportioned upon deferred dividend policies. "Treated as an abatement of premium" means of the premium for the taxable year. Where the dividend paid back is in excess of the premium received from the policyholder within the taxable year, there may be excluded from gross income only the amount of such premium received. Where no premium is received from the policyholder within the taxable year, the company is not entitled to exclude from its premiums received from other policyholders any amount in respect of such dividend payment.

Deductions.—Insurance companies are entitled to the same deductions from gross income as other corporations, and also to the deduction of the net addition required by law to be made within the taxable year to reserve funds and of the sums other than dividends paid within the taxable year on policy and annuity contracts. "Paid" includes "accrued" or "incurred" (construed according to the method of accounting upon the basis of which the net income is computed) during the taxable year, but does not include any estimate for losses incurred but not reported during the taxable year. As payments on policies there should be reported all death, disability and other policy claims (other than dividends as above specified) paid within the year, including fire, accident and liability losses, matured endowments, annuities, payments on installment policies and surrender values actually paid.

Addition Required by Law to Reserve Funds.—Insurance companies may deduct from gross income the net addition required by law to be made within the taxable year to reserve funds, including in the case of assessment insurance companies the actual deposit of sums with state or territorial officers pursuant to law as additions to guarantee or reserve funds. This is considered to mean the net addition required by the specific statutes of the states within which the taxpayer transacts business. A requirement by a state insurance commissioner that a net addition shall be made to certain amounts retained to meet specified liabilities is not a net addition required by law to be made to reserve funds within the meaning of the statute. Only reserves commonly recognized as reserve funds in insurance accounting are to be taken into consideration in computing the net addition to reserve funds required by law. In the case of a fire insurance company, the only reserve fund commonly recognized is the "unearned-premium" fund.

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Casualty companies may deduct losses incurred within the taxable year, but unless the net addition to the unpaid loss reserve required by law exceeds such losses incurred, no deduction for the net addition to the unpaid loss reserve may be taken. In any event, only the excess of such net addition over such losses may be deducted. In the case of life insurance companies the net addition to the "reinsurance reserve" and the "reserve for supplementary contracts not involving life contingencies," and the net addition to any other reserve funds necessarily maintained for the purpose of liquidating policies at maturity, are legally deductible. An increase in the reserve maintained by a life insurance company to pay dividends on deferred dividend policies may not be deducted from gross income. Mutual hail and mutual cyclone insurance companies are entitled to deduct from gross income the net addition which they are required to make to the "guaranty surplus" fund or similar fund.

Combined Life, Health, and Accident Policies.— Corporations which issue combined policies of life, health, and accident insurance on the weekly premium payment plan, continuing for life and not subject to cancellation, may deduct from gross income only such portion of the net addition, not required by law, made within the taxable year to reserve funds as is needed for the protection of the holders of such combined policies. In general the net addition to any fund especially maintained for the protection of such policyholders may be deducted. The determination by the company of the need for such addition is subject to review by the Commissioner, and the return of income should be accompanied by a full explanation of the basis upon which such fund and the additions to it are determined.

Mutual Marine Insurance Companies. — Mutual marine insurance companies should include in gross income the gross premiums collected and received by them less amounts paid for reinsurance. They may deduct from gross income amounts repaid to policyholders on account of premiums previously paid by them, together with the interest actually paid upon such amounts between the date of ascertainment and the date of payment thereof. The remainder of the premiums accordingly form part of the net income of the company, except to the extent that they are subject to the deductions allowed insurance companies in general and other corporations.

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Mutual Insurance Companies.—Mutual insurace companies (other than mutual life and mutual marine insurance companies), which require their members to make premium deposits to provide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses and reinsurance reserves. If, however, any portion of such amount is applied during the taxable year to the payment of losses, expenses or reinsurance reserves, for which a separate allowance is taken, then such portion is not deductible; and if any portion of such amount for which an allowance is taken is subsequently applied to the payment of expenses, losses, or reinsurance reserves, then such payment cannot be separately deducted. An amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and losses, may not both be deducted. A company which invests part of the premium deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which has a guaranty capital is taxed like other mutual fire insurance companies. A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.

Returns.—Insurance companies transacting business in the United States or deriving income from sources therein, are required to file a return on Form 1120. Whenever possible, a copy of the report to the state insurance department should be submitted with the return.

FARMERS

All gains, profits, or income derived from the sale or exchange of farm products, whether produced on the farm or purchased and resold, must be included in the return for the year in which the products were actually marketed and sold, unless an inventory is used. The term "farm" embraces the farm in the ordinarily accepted sense and includes stock, dairy, poultry, fruit and truck farms, also plantations, ranches, and all land used for farming operations. All individuals, partnerships, or corporations that cultivate, operate, or manage farms for gain or profit, either as

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owners or tenants, are designated farmers. A person cultivating or operating a farm for recreation or pleasure, the operation of which results in a continual loss from year to year, is not regarded as a farmer.

In the case of the sale of machinery, and of animals purchased as draft or work animals, or solely for breeding purposes and not for resale, any excess over the cost thereof, less all sums theretofore deducted for depreciation, must be included as gross income by the taxpayer. Where farm produce is exchanged for merchandise, groceries or mill products, the market value of the article or product received in exchange is to be returned as income. Rents received in crop shares are to be returned as of the year in which the crop shares are reduced to money or a money equivalent. If a farmer is engaged in producing crops which require more than a year from the time planted until they are gathered and sold, the income therefrom may be computed upon the crop basis; but the entire cost of producing the crops must be deducted for the year in which the gross income from the crops is realized. When live stock purchased is sold, its cost is to be deducted from the sales price in ascertaining the amount of gain or profit resulting. If, however, an inventory is used, the cost price of the article sold must not be taken as an additional deduction in the return, as such cost price would be reflected in the inventory.

The Treasury Department has provided a special work sheet or schedule of farm income and expenses, Form 1040-F. It may be used by farmers who work their own farms or rent them out on shares, or by tenants. If two or more farms are operated it may be desirable to fill out a separate sheet for each farm. This schedule is to be delivered to the collector, with the taxpayer's income tax return on Form 1040 or 1040-A.

Expenses Allowable.—A farmer operating a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in carrying on the business. The cost of ordinary tools of short life or small cost, such as hand tools, shovels, rakes, etc., may be included. The cost of feeding and raising live stock may be treated as an expense deduction in so far as such cost represents actual outlay, but not including the farm products grown upon the farm or the labor of the taxpayer. If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred exceed the receipts therefrom,

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the entire receipts from the sale of products may be ignored, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions.

The cost of farm machines and farm buildings represents a capital investment and is not an allowable deduction as an item of expense. Amounts expended in the developing of farms, orchards, and ranches, prior to the time when the productive state is reached, may be regarded as investments of capital, as are amounts expended in purchasing draft or work animals or live stock, either for resale or for breeding purposes. The purchase price of an automobile even when wholly used in carrying on farming operations is not deductible but is regarded as an investment of capital. The cost of gasoline, repairs, and upkeep of an automobile used wholly in the business of farming is deductible as an expense. If used partly for business purposes and partly for the pleasure or convenience of the taxpayer or his family, such cost may be apportioned according to the extent of the use for purposes of business and pleasure or convenience, and only the proportion of such cost justly attributable to business purposes is deductible as a necessary expense.

Losses.—Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for favorable markets, no deduction on account of shrinkage in weight or physical value or by reason of deterioration in storage is allowable. The total loss by frost, storm, flood or fire of a prospective crop or of a crop which has not been sold is not deductible in computing net income. A farmer engaged in raising and selling stock, cattle, sheep, horses, etc., is not entitled to claim as a loss the value of animals that perish from among those animals that were raised on the farm. If live stock has been purchased and afterwards dies from disease, exposure, or injuries, or is killed by order of the authorities of a state or the United States, the actual purchase price of such stock less any depreciation which may have been previously claimed with respect to such perished live stock, and less any insurance or indemnity recovered, may be deducted as a loss. The actual cost of other property, less depreciation already allowed, destroyed by order of the authorities of a state or of the United States may also be claimed as a loss in the same manner. If, however, reimbursement is made by a state or the United States in whole or in part on account of stock killed or property destroyed, the amount received is returnable as income for the year in which reimbursement is made.

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In determining the cost of stock for the purpose of ascertaining the deductible loss, there shall be taken into account only the purchase price and not the cost of any feed, pasturage or care which has been deducted as an expense of operation. Where gross income is ascertained by inventories, no deduction can be made for live stock or products lost during the year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of live stock or products on hand at the end of the year. If an individual owns and operates a farm, in addition to being engaged in other business, and sustains a loss, the amount of loss sustained may be deducted from gross income from all sources, except where the farm is operated for recreation or pleasure, in which case no losses are deductible, as they are regarded as personal expenses.

Depreciation in the Case of Farmers.—A reasonable allowance for depreciation may be claimed on farm buildings (other than a dwelling occupied by the owner), farm machinery, and other physical property, including live stock purchased for draft, dairy, or breeding purposes, but no claim for depreciation on live stock raised, or purchased for resale will be allowed. Live stock purchased for draft, breeding, or dairy purposes or for any purpose other than resale, may be included in the inventory for each year at a figure which will reflect the reduction in value estimated to have occurred during the year through increase of age or other causes. Such reduction in value should be based on the cost and estimated life of the live stock. If an inventory is not used, a reasonable allowance for depreciation may be claimed, based upon the cost of draft and work animals and animals kept solely for breeding purposes and not for resale.

NONRESIDENT ALIENS

Gross Income.—The 1918 law provides that in the case of nonresident alien individuals and foreign corporations, gross income shall include only the gross income from sources within the United States, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, dividends from resident corporations, and including all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture and disposition of goods within the United States. In addition to these items of income which are specifically mentioned, there should also be included as gross in-

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come, rentals and royalties from property and income from business carried on in the United States, interest on deposits in banks located in the United States, income from capital invested therein, and income from services rendered or labor performed therein.

Royalties paid to nonresident aliens under an agreement for the purchase of certain patent rights, payments being based upon the quantity of goods produced by the use of such patents, represent income accruing to nonresident aliens by reason of property owned or business carried on within the United States, and must be accounted for in the return of the recipient.

A nonresident alien owning stock in an American corporation, disposing of the same, both sale and delivery being effected in the United States, must return any profit as income, it being derived from sources within the United States.

Interest received by foreign consuls on bank deposits of personal funds in the United States constitutes income from sources within the United States, and as such is subject to tax.

Income received by nonresident aliens from partnerships and personal service corporations deriving income from sources within the United States, must be included by them in their returns in accordance with the usual rules regarding income of this character.

Income Exempt from Tax.—A nonresident alien taxpayer need not report any income which citizens are not required to report.* Salaries, wages, commissions and rents paid by domestic enterprises to nonresident alien employees for services rendered entirely in a foreign country or for property located in a foreign country, are not subject to tax as income from a source within the United States. The same is true of compensation received by nonresident alien munitions inspectors and purchasing agents from foreign governments. Dividends on stock and interest on notes of corporations organized in the United States, doing no business and owning no property therein, paid to nonresident alien individuals and corporations, are not subject to tax; nor does the tax apply to charter money or freight payments received by a foreign owner in regard to a vessel operated between the United States and foreign ports, if the recipient of the income maintains no regular agency in the United States and is not doing business therein.

Liberty Bond Exemptions.—By virtue of Section 4 of the Victory Liberty Loan Act of March 3, 1919, amending Section 3 of the Fourth Liberty Bond Act of July 9, 1918, the interest

*See page 65.

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received on and after March 3, 1919, on bonds, notes and certificates of indebtedness of the United States, and bonds of the War Finance Corporation, while beneficially owned by a nonresident alien individual or a foreign corporation, partnership, or association not engaged in business in the United States, is exempt from all income and war profits and excess profits taxes, and interest on any such bonds need not be included in the taxpayer's return unless for purposes of information. Interest on bonds of nonresident corporations or of foreign governments or states, or their political subdivisions is not income from sources within the United States merely because such interest is paid by a fiscal agent in the United States and is exempt from income, war profits and excess profits taxes in the hands of a nonresident alien individual, fiduciary, partnership, or corporation.

Deductions.—In the case of nonresident alien individuals or foreign corporations the deductions* for business expenses paid or incurred, losses sustained during the taxable year incurred in trade or business, bad debts, exhaustion, wear and tear of property, amortization, depletion and depreciation of mines, oil and gas wells, other natural deposits and timber, substantial losses resulting from material reduction in the value of the inventory, and taxes imposed by the authority of any foreign country (except income, war profits and excess profits taxes and those assessed against local benefits of a kind tending to increase the value of the property assessed) upon property or business, are allowed only if and to the extent that such deductions are connected with income arising from sources within the United States, the proper apportionment and allocation of the deductions with respect to the sources of income within and without the United States being determined under regulations prescribed by the Commissioner.

A nonresident alien individual or foreign corporation is allowed as a deduction for interest paid or accrued, only the proportion of such interest which the amount of the gross income from sources within the United States bears to the amount of the gross income from all sources within and without the United States. A nonresident alien individual may deduct any losses sustained in transactions entered into for profit, though not connected with his trade or business, only as to such transactions within the United States, and any losses not connected with the trade or business, arising from fire, storm, shipwreck or other casualty or from theft, only of property

*See pages 71 to 95.

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within the United States. A nonresident alien individual, but not a foreign partnership or corporation, is allowed to deduct contributions or gifts made to domestic corporations or to the Vocational Rehabilitation Fund authorized by Section 7 of the Vocational Rehabilitation Act. A foreign corporation is allowed, however, to deduct in full the amounts received as dividends from a corporation taxable on its net income or dividends received from a personal service corporation out of its earnings upon which income tax has been imposed.

A Canadian corporation which sells part of its product in the United States, and part in Canada, should report its deductions for cost of manufacture, exclusive of interest paid on its indebtedness, in the same proportion as the quantity of its products sold in the United States bears to the total quantity sold.

Allowance of Deductions and Credits.—Unless a nonresident alien individual or foreign corporation renders a full and accurate return of income, the tax will be collected on the basis of the gross income (not the net income) from any sources within the United States. Where a nonresident alien has various sources of income within the United States, so that from any one source, or from all sources combined, the amount of income subjects him to surtax, and a return of income has not been filed by him or on his behalf, the Commissioner will cause a return to be made and will include therein all such income concerning which he has information, and will assess and collect the tax without allowance for credits or deductions. The exception to the rule that a nonresident alien may only secure the benefit of the credits for the purpose of the normal tax by claiming them upon filing a return of income, is found in the case of a nonresident alien employee who files with his employer Form 1115, duly executed under oath, claiming the benefit of the credit for personal exemption or the exemption for dependents or both, to which he may be entitled as a citizen or subject of a country which either imposes no income tax or, in imposing an income tax, allows a credit for personal exemption, or credit for dependents, or both, to a citizen of the United States not residing in such country, as contemplated by Section 216 of the law.

A nonresident alien individual, who is a citizen or subject of the following countries, is entitled, for the purpose of the normal tax, to

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such credit for personal exemption and exemption for dependents as his family status may warrant:

Argentina	Galicia	Roumania
Belgium	Goritz	Russia (including
Bohemia	Gradisca	Poles owing
Bolivia	Herzegovina	allegiance to
Bosnia	Istria	Russia)
Brazil	Lower Austria	Salzburg
Bucowina	Mexico	Santa Domingo
Canada	Montenegro	Serbia
Carinthia	Moravia	Siam
Carniola	Morocco	Silesia
Chile	Newfoundland	Spain
China	Nicaragua	Styria
Cuba	Norway	Trieste
Dalmatia	Panama	Tyrol
Denmark	Paraguay	Upper Austria
Ecuador	Persia	Union of South
Egypt	Peru	Africa
France	Portugal	Venezuela.

A nonresident alien individual, who is a citizen or subject of the following countries, is entitled to a credit for personal exemption, but not for dependents:

Bachka	Croatia	Slavonia
Banat of	Salvador	Slovakia
Temesvar	India	Transylvania.
	Italy	

A nonresident alien individual, who is a citizen or subject of the following countries, is not entitled to a credit for either personal exemption or exemption for dependents:

Australia	Great Britain	The Netherlands
Costa Rica	and Ireland	New Zealand
	Japan	Sweden.

A nonresident alien individual who is a citizen or subject of a country not included in the foregoing lists, to obtain credit for either the personal exemption or exemption for dependents, must establish to the satisfaction of the Commissioner, that his country does not impose an income tax, or that in imposing an income tax, it grants similar credits to citizens of the United States not residing therein.

For returns of nonresident alien individuals and foreign corporations, see pages 97, 98 and 137.

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PARTNERSHIPS AND PERSONAL SERVICE CORPORATIONS

Partnerships and personal service corporations as such are not subject to tax under the statute, but are required to make returns of income regardless of the amount thereof.* Individuals carrying on business in a partnership and the stockholders of a personal service corporation are, however, taxable upon their distributive shares of the net income of the partnership or personal service corporation, whether distributed or not, and are required to include such distributive shares in their returns. The net income of the partnership or personal service corporation shall be computed on the same basis as the net income of an individual, except that the deduction of contributions is not permitted.

Distributive Shares of Partners.—The distributive share of the net income of a partnership which a partner is required to include in his return is his proportionate share of the net income of the partnership, either

(a) for the taxable year upon the basis of which the net income of the partner is computed, or,

(b) if his net income is computed upon the basis of a taxable year different from that of the partnership, for the taxable year of the partnership ending within the taxable year upon the basis of which the partner's net income is computed. Amounts earned and distributed by a partnership to a partner after the end of its taxable year and before the end of his corresponding taxable year should be accounted for both by the partnership and partner in their returns for their next succeeding taxable years.

Distributive Shares of Stockholders of Personal Service Corporation.—A stockholder of a personal service corporation is required to include in his return for the taxable year the following:

(a) any dividends paid by the corporation in such year out of earnings or profits accumulated since February 28, 1913, and before January 1, 1918;

(b) his share of any distribution made by the corporation in such year out of earnings or profits accumulated since December 31, 1917, and since the close of its taxable year ending with or during his next preceding taxable year; and

(c) his distributive share of the undistributed net income of the corporation for its taxable year ending with or during his taxable year, provided he was at the close of its taxable year a stockholder in the corporation, notwithstanding he might since have ceased to be a stockholder.

*See page 25]

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Personal Service Corporation Defined.—A "personal service corporation" means a corporation whose income is derived from a profession or business—

(a) which consists principally of rendering personal service;
(b) the earnings of which are to be ascribed primarily to the activities of the principal owners or stockholders; and
(c) in which the employment of capital is not necessary or is only incidental.

The term does not include:

(a) foreign corporations;
(b) corporations 50 per centum or more of whose gross income consists of income derived from trading as a principal; and
(c) corporations 50 per centum or more of whose gross income consists of income derived from Government contracts made between April 6, 1917, and November 11, 1918, inclusive.

A corporation is not a personal service corporation merely because less than 50 per centum of its gross income is derived from trading as a principal or from Government contracts, nor can a corporation be considered a personal service corporation when another corporation owns or controls substantially all its stock, or when substantially all of its stock and the stock of another corporation (not itself a personal service corporation) forming part of the same business enterprise, is owned or controlled by the same interests.

Personal Services Rendered by Personal Service Corporation.—In order that a corporation may be deemed to be a personal service corporation, its earnings must be derived principally from compensation for personal services rendered by the corporation. Merchandising or trading either in commodities or the services of others is not rendering personal service. Conducting an auction, agency, brokerage or commission business strictly on the basis of a fee or commission is rendering personal service. If, however, a corporation assumes risks of market fluctuations, bad debts, failure to accept shipments, etc., or if it guarantees accounts of the purchaser, or is in any way responsible to the seller for the payment of the purchase price, the transaction is one of merchandising or trading, even though the goods are shipped directly from the producer to the consumer. If a commission or fee is based on a difference in the prices at which the seller sells, and the buyer buys, the presumption is raised that the transaction is one of merchandising or trading, and it will be so considered in the absence of satisfactory evidence to the contrary. No weight can be given to the fact that the invested capital of the corporation or the

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actual investment of the principal owners or stockholders is comparatively small. If the use of capital is necessary, or more than incidental, capital is a material income-producing factor and the corporation is not a personal service corporation. A corporation is not a personal service corporation if it carries on a business which ordinarily requires the use of capital, irrespective of whether the owners or stockholders have invested substantial capital.

Activities of Stockholders of Personal Service Corporation.—A corporation is not considered a personal service corporation, even though it renders personal service, unless

(a) the principal owners or stockholders are regularly engaged in the active conduct of its affairs, and its earnings are to be ascribed primarily to their activities; and

(b) its affairs are conducted principally by such owners or stockholders.

Where the principal owners or stockholders merely supervise or direct a force of employees, a corporation is not a personal service corporation. If employees contribute substantially to the services rendered by a corporation it is not a personal service corporation unless in every case in which such services are so rendered, the value of and the compensation charged therefor are to be attributed primarily to the experience or skill of the principal owners or stockholders. No definite percentage of stock or interest in the corporation, which must be held by those engaged in the active conduct of its affairs in order that they may be deemed to be the principal owners or stockholders, can be prescribed as a conclusive test. No corporation or its owners or stockholders shall, however, make a return in the first instance, on the basis of its being a personal service corporation unless at least 80 per centum of its stock is held by those regularly engaged in the active conduct of its affairs.

Application of Different Rates Where Fiscal Year of Partnership or Personal Service Corporation Ends in 1919.—Any deductions, exemptions or credits to which a partner in a partnership or a stockholder of a personal service corporation with a fiscal year ending in 1919 is entitled, shall first be applied against his income subject to the rates for the calendar year 1919, unless of a kind properly chargeable against income taxable at the rates for the calendar year 1918. In determining the rates of tax applicable to the amounts of the distributive shares of the partners or stockholders attributable to the calendar years 1918 and 1919, respectively, the amounts subject to the rates for the calendar year 1919 shall be placed in the lower

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brackets of the rate schedule provided in the law, and the amounts attributable to the calendar year 1918 in the next higher brackets of the rate schedule applicable to that year.

Association Distinguished from Partnership.—An organization, the membership interests in which are transferable without the consent of all members, and which is conducted by trustees or directors and officers without the active participation of all members as such, is an association and not a partnership. A partnership bank conducted like a corporation and so organized that the interests of its members may be transferred without the consent of the other member, is a joint stock company or association within the meaning of the statute. A partnership bank, the interests of whose members cannot be so transferred, is a partnership.

Limited Partnerships.—So-called limited partnerships of the type authorized under the statutes of New York and most other states, Michigan and Illinois limited partnerships and a California special partnership, are partnerships and not corporations within the meaning of the statute.

In all doubtful cases limited partnerships will be treated as corporations unless they submit satisfactory proof that they are not in effect so organized.

Taxation of Partners and Stockholders of Personal Service Corporation When Fiscal Year Ends in 1919.—If the fiscal year of a partnership or a personal service corporation began in 1918 and ends in 1919, the rates of tax for the calendar year 1918 apply to each partner's or stockholder's distributive share of the net income attributable to the calendar year 1918 and the rates for the calendar year 1919 to the distributive share of each partner or stockholder of such net income attributable to the calendar year 1919. Each partner's or stockholder's distributive share for such fiscal year attributable to the calendar year 1918 and the calendar year 1919 is found by determining the net income of the partnership or personal service corporation for its entire fiscal year both in accordance with the law applicable to the calendar year 1918 and the calendar year 1919 and the distributive share thereof of each partner or stockholder, and then taking such proportion thereof as the part of such fiscal year falling within the calendar year 1918 and the calendar year 1919 bears to the full fiscal year.*

*See Reg. 45, Arts. 326, 334.

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For credits allowed partners in their individual tax returns see page 7.

Returns.—The return shall be on Form 1065, Revised,* sworn to by one of the partners, in the case of a partnership, and by the president and treasurer in the case of a personal service corporation. Such return shall be made for the taxable year of the partnership or personal service corporation, that is, for its annual accounting period, whether fiscal year or calendar year irrespective of the taxable year of the partners or stockholders. For the basis of return, where the partnership or personal service corporation makes any change in its accounting period, see pages 32 and 96.

The individual partners and the stockholders of a personal service corporation are taxable, however, upon their distributive shares of the net income of the partnership or personal service corporation, whether distributed or not, and are required to include such distributive shares in their returns.

FIDUCIARIES

Fiduciary Defined.—"Fiduciary" is a term which applies to all persons who occupy positions of peculiar confidence towards others, such as trustees, executors and administrators. A fiduciary for income tax purposes is a person who holds in trust an estate to which another has the beneficial title or in which another has a beneficial interest, or receives and controls income of another, as in the case of receivers. A committee of the property of an incompetent person is a fiduciary.

There may be a fiduciary relationship between an agent and principal, but the word "agent" does not denote a fiduciary. A fiduciary relationship cannot be created by a power of attorney. An agent having entire charge of property, with authority to effect and execute leases with tenants entirely on his own responsibility and without consulting his principal, merely turning over the net profits from the property periodically to his principal by virtue of authority conferred upon him by a power of attorney, is not a fiduciary within the meaning of the statute. In cases where no legal trust has been created in the estate controlled by the agent and attorney, the liability to make a return rests with the principal.

Classification of Estates and Trusts.—For income tax purposes, income of estates and trusts may be divided into two classes:

*1065-A, Revised, where return is made for fiscal year ending in 1919.

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First: Income, the tax upon which is imposed upon the estate or trust and paid by the fiduciary, consisting of:

(a) Income received by estates of deceased persons during the period of administration or settlement, except as provided in "f" below;

(b) Income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests;

(c) Income held in trust for future distribution under the terms of the will or trust;

Second: Income, the tax upon which is imposed upon and paid by the beneficiary, consisting of:

(d) Income which is to be distributed to beneficiaries periodically, whether or not at regular intervals;

(e) Income collected by the guardian of an infant to be held or distributed as the court may direct;

(f) Income of the estate of any deceased person which during the period of administration or settlement is properly paid or credited to any beneficiary.

Income of Estates and Trusts Taxed to Fiduciary.—In the case of estates or trusts falling within subdivisions (a), (b) and (c), the income is taxed to the fiduciary as to any single individual, except that in cases falling under (a) there may first be deducted from the income of the decedent's estate any income properly paid or credited to any beneficiary. Such return shall be on Form 1040, Revised, except that it may be on Form 1040-A, Revised, where the net income does not exceed $5,000 for the individual, estate or trust for which the fiduciary acts.

Income of Estates and Trusts Taxed to Beneficiaries.—In the case of estates and trusts falling under (d), (e) and (f), the fiduciary is required to make an information return on Form 1041, Revised, in which must be included a statement of each beneficiary's distributive share of the net income of the estate or trust, whether or not distributed before the close of the taxable year for which the return is made. In all such cases, the income is taxable directly to the beneficiary or beneficiaries, who must make a return on Form 1040, Revised, or 1040-A, Revised. Each beneficiary must include in his return his distributive share of the net income, whether distributed or not. If the taxable year on the basis of which he makes his return fails to coincide with the annual accounting period of the estate or trust, then he need only include in his return his distributive share for such accounting period ending within his taxable year.

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Return by Fiduciary.—Every fiduciary, or at least one of joint fiduciaries, must make a return of income for the individual estate or trust whose income is in his charge,

(a) If the net income of any individual beneficiary is $2,000 or over if married, and living with husband or wife, or is $1,000 or over in other cases,

(b) If the net income of the estate or trust is $1,000 or over, or

(c) If any beneficiary is a nonresident alien.

Where, under the terms of the will or deed, the trustee may in his discretion distribute or accumulate the income, such income is taxed to the trustee, irrespective of his exercise of discretion, and the fact that the ultimate beneficiary may be a person exempt from tax does not affect the imposition of the tax. A statutory allowance paid a widow out of the corpus of the estate is not deductible from gross income. As an intestate's real estate does not pass to his administrator, upon the sale by heirs, whether before or after settlement of the estate, each heir is taxed individually on any profit derived. In the case of a decedent, if the net income from the beginning of the taxable year to the date of death was $1,000, if unmarried, or $2,000, if married and living with husband or wife, the executor or administrator shall make a return for the decedent on Form 1040, Revised, or Form 1040-A, Revised, as the case may be.

Where a citizen or resident fiduciary has control of income distributable to a nonresident alien beneficiary, the fiduciary must make a return for such nonresident alien on Form 1040, Revised, or 1040-A, Revised, and pay the tax. If there are two or more beneficiaries, the fiduciary must render an information return on Form 1041, Revised, and also a return on Form 1040, Revised, or 1040-A, Revised, for each nonresident alien beneficiary.

Return by Guardian or Committee.—A fiduciary acting as the guardian of a minor, or as the committee of an insane person, having a net income of $1,000 or $2,000, according to the marital status of such person, must make a return for such minor or incompetent on Form 1040, Revised, or Form 1040-A, Revised, and pay the tax. In case the minor makes the return or causes it to be made the fiduciary need not make another return.

Returns Where Two Trusts.—In the case of two or more trusts, the income of which is taxable to the beneficiaries, the trusts being created by the same person and in charge of the same trustee, the trustee shall make a single return on Form 1041, Revised, for all such trusts, notwithstanding that they may arise from different instruments. When, however, a trustee holds trusts created

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by different persons for the benefit of the same beneficiary, he shall make a return on Form 1041, Revised, for each trust separately.

Return by Receiver.—A receiver acting for an individual must render a return of income on Form 1040, Revised, or Form 1040-A, Revised, and pay the tax for his trust, but a receiver of only part of the property of an individual need not do so. A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common law receivers of all the property or business of an individual must make returns.

Decedent's Estate During Administration.—The "period of administration or settlement of the estate" is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, particularly the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. Where an executor, who is also named as trustee, fails to obtain his discharge as executor the period of administration continues up to the time when the duties of administration are completed.

Computation of Income of Estates and Trusts.—The net income of an estate or trust shall be computed in the same manner and on the same basis as the net income of an individual, except that, in lieu of the deduction for contributions allowed to an individual, there shall be allowed as a deduction from the gross income any part thereof which during the taxable year is, pursuant to the will or trust deed, paid to or permanently set aside for the United States, a state, a territory or any political subdivision thereof, or the District of Columbia, or any corporation or association, organized and operated exclusively for religious, charitable, scientific or educational purposes or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. In the event of delivery of property in kind to a legatee or distributee, no income is realized.

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Gain or Loss from Sale of Property Included in Original Trust or Estate.—The profit or loss from the sale or other disposition of property included in the original trust or estate is the difference between the selling price and the fair market value of the property at the time of the decedent's death or at the date of the creation of the trust, unless the decedent's death occurred or the trust was created prior to March 1, 1913, in which case the fair market value upon that date is the basis for determining gain or loss. Profit derived from the sale or other disposition of assets of a trust or estate, even though considered a capital asset of the trust or estate, is taxable income.

Losses Sustained by Estates or Trusts as Affecting Taxable Income of Beneficiaries.—The Treasury Department has ruled that—

(a) Any loss resulting from the sale of stocks, bonds, or other property owned by a trust, considered an allowable deduction from the gross income of an individual, is an allowable deduction from the gross income of a trust, whether or not the income of such trust is "to be distributed to the beneficiary periodically, whether or not at regular intervals," and whether or not there is any requirement in the instrument creating the trust, a decree of court, or a general law that the principal of the trust estate be kept intact at the expense of income as against such loss; that

(b) Such a deduction is not allowable as against the current or future gross income of the present beneficiaries or of those who will receive the property at the termination of the trust; and that

(c) A beneficiary is not required to include in his personal return as a part of "his distributive share, whether distributed or not, of the net income of the trust for the taxable year," any part of the amounts allowed to the trust as a whole as a deduction for loss resulting from the sale of the property.

Deductions Allowed Estates and Trusts.—Distinction is made between (1) expenses which are charges against the corpus of an estate when created and (2) expenses which are incident to the business management of the estate. In computing net income items falling under (1) are not proper deductions, whereas items falling under (2) are proper deductions.

In accordance with the foregoing, executor's commissions, court costs, and attorney's fees in connection with the settlement of an estate or the creation of a trust, which are directly chargeable to the corpus of the estate or trust, are not proper deductions in determining net income. Likewise, expenses incurred by a legatee or other person in litigation to sustain or upset a will are not proper deductions in determining net income. On the other hand, if trus-

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tees' commissions are deducted from the income of the estate or trust distributable among the beneficiaries, the amount of such commissions should be entered as legitimate and necessary expenses properly deductible by the fiduciary for income tax purposes.

Expenses necessary to carrying on the business of the trust or estate by the fiduciary are deductible in the same manner as similar expenses of an individual. Likewise, interest, taxes and losses are subject to the same general rules relating to these deductible items as apply to individuals.

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PART II. INCOME TAX—NET INCOME

DETERMINATION OF NET INCOME

Net income means gross income less allowable deductions, and is determined in accordance with the method of accounting regularly employed in keeping the books of the taxpayer

Net income is computed with respect to a fixed period, usually twelve months, such period being known as the taxable year. Items of income and of deductions, both of which are elements in the computation of net income, need not be in the form of cash, it being sufficient that if otherwise properly included in the computation they can be valued in terms of money. The time as of which any item of income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as to clearly reflect the taxpayer's income. If the accounting method regularly employed clearly reflects his income, it must be followed with respect to the time as of which items of gross income and deductions are to be accounted for. If the taxpayer does not regularly employ a method of accounting clearly reflecting his income, the computation must be made in such manner as in the Commissioner's opinion does clearly reflect it.

Basis for Computing Net Income.—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income but no method will be so regarded unless all items of gross income and all deductions are treated with reasonable consistency. All items of gross income must be included in the return for the taxable year in which they are received and deductions taken accordingly, unless they are properly accounted for as of a different period in accordance with some other approved method of accounting. In every case the return must be made on a basis clearly reflecting the income of the taxpayer. One of two methods should be employed, the cash or receipt and disbursement basis or the accrual basis which are explained hereafter. No uniform method of accounting can be prescribed, the law contemplating that each taxpayer shall adopt such methods as are best suited to his purpose, but he must make a return of his true income and must, therefore,

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maintain such accounting records as will enable him to do so. Among the essentials are the following:

(1) In all cases in which the production, purchase or sale of merchandise of any kind is an income-producing factor inventories of the merchandise on hand (including finished goods, work in process, raw materials and supplies) should be taken at the beginning and end of the year and used in computing the net income of the year;

(2) Expenditures made during the year should be properly classified as between capital and income, that is to say, that expenditures for items of plant, equipment, etc., which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account; and

(3) In any case in which the cost of capital assets is being recovered through deductions for wear and tear, depletion or obsolescence any expenditure (other than ordinary repairs) made to restore the property or prolong its useful life should be charged against the property account or the appropriate reserve and not against current expenses.

Accounting Period.—A taxpayer's return is made and his income is computed for his taxable year, which means his fiscal year, or the calendar year if he has not established a fiscal year. Fiscal year means an accounting period of twelve months ending on the last day of any month other than December. No fiscal year will be recognized unless before its closing it was definitely established as an accounting period by the taxpayer and the books were kept in accordance therewith. The taxable year 1919 is the calendar year 1919, or any fiscal year ending therein.

Accounting Period Changes.—Where a taxpayer changes his accounting period, and not merely his taxable year to conform with his existing accounting period, he must give, as soon as possible, a written notice of such change and his reasons therefor to the collector for transmission to the Commissioner. The latter will not approve a change of the basis of computing net income, unless such notice is given at a time which is both at least thirty days before the due date of the taxpayer's return on the basis of his existing taxable year and at least thirty days before the due date of his return on the basis of the proposed taxable year. If the change is approved by the Commissioner, the taxpayer must thereafter make his returns on the basis of the new accounting period.

INVENTORIES

In order to reflect the net income correctly inventories must be taken by the taxpayer at the beginning and end of each year in

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every case in which the production, purchase or sale of merchandise is an income-producing factor. Inventories should include raw materials and supplies on hand that have been acquired for sale, consumption, or use in productive processes, together with all finished or partly finished goods. Title to merchandise included in the inventory should be vested in the taxpayer, goods merely ordered for future delivery and for which no transfer of title has been effected being excluded. Merchandise sold but not shipped to the customer at the date of the inventory should be included, together with any merchandise out upon consignment, unless such goods have been included in the sales of the taxable year, in which case they should not be taken in the inventory. It should also include merchandise purchased, although not actually received, to which title has passed to the purchaser, and there should be taken into the accounts all invoices or other charges in respect of merchandise properly included in the inventory but which is in transit or which for other reasons has not been reduced to physical possession.

Valuation of Inventories.—Inventories should be valued at cost, or cost or market whichever is lower. The basis adopted must be applied to each item and not merely to the total of the inventory. Thus, if the second method is adopted the value of each item in the inventory will be measured by market, if that is lower than cost, or by cost if lower than market. The taxpayer, regardless of his past practice, was allowed to adopt the basis of cost or market, whichever is lower, for his 1918 inventory, provided a disclosure of the change was made in the return. Thereafter changes may be made only after permission is received from the Commissioner. Inventories should be recorded in a legible manner and properly computed and summarized and should be preserved as a part of the accounting records of the taxpayer. Goods taken in the inventory which have been so intermingled that they cannot be identified with specific invoices will be deemed to be the goods most recently purchased.

Inventories at Cost.—"Cost" means (1) in the case of merchandise purchased, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed, plus transportation or other necessary charges incurred in acquiring possession of the goods; (2) in the case of merchandise produced by the taxpayer (a) the cost of raw materials and supplies entering into or consumed in

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connection with the product, (b) expenditures for direct labor, (c) indirect expenses, incident to the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital whether by way of interest or profit. In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry.

Inventories at Market.—"Market" means the current bid price prevailing at the date of the inventory for the particular merchandise, and is applicable to goods purchased and on hand and to basic materials in goods in process of manufacture and in finished goods on hand, exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts at fixed prices entered into before the date of inventory. Where no open market quotations are available the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available to him, such as specific transactions in reasonable volume entered into in good faith, or compensation paid for cancellation of contracts for purchase commitments. The burden of proof will rest upon the taxpayer in each case to satisfy the Commissioner of the correctness of the prices adopted. It is recognized that in the latter part of 1918, by reason among other things of governmental control not having been relinquished, conditions were abnormal and in many commodities there was no such scale of trading as to establish a free market. In such a case, when a market has been established during the succeeding year, a claim may be filed for any loss sustained in accordance with the provisions of Section 214 (a) (12) or Section 234 (a) (14) of the law.

Inventories by Dealers in Securities.—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either (a) at cost or (b) at cost or market value, whichever is lower, may make his return upon the basis upon which his accounts are kept if a description of the method employed is included in or attached to the return, and all securities are inventoried by the same method and such method adhered to in subsequent years, unless another is authorized by the Commissioner. A "dealer in securities" is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their

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resale to customers, that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, and not in the course of an established business, and officers of corporations and members of partnerships, who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule. A bank or other institution having a regularly established department for the merchandising of securities is entitled to inventory its securities acquired and held for resale as though it were solely a dealer in securities.

BASIS FOR DETERMINING GAIN OR LOSS

For the purpose of ascertaining the gain or loss resulting from the sale or exchange of property, the basis is its fair market price or value as of March 1, 1913, if acquired prior thereto, or if acquired on or after that date, its cost or its approved inventory value, proper adjustment being made in each case for any depreciation or depletion sustained. What the fair market price or value was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear, and no method of determining this value can be stated which will meet all circumstances. The fair market price or value as of March 1, 1913, is held to be the fair market price or value as of the entire day, and in case of variations between the opening and closing prices for the day, to be the average price. This would be conditioned upon showing that the exchange quotation represented a fair market price or value of the stock, since that is what controls. The fair market value as of March 1, 1913, has no bearing on the determination of invested capital of a corporation for the purpose of the war profits and excess profits tax.

The cost of property acquired on or after March 1, 1913, is the actual price paid for it, plus expenses incident to its procurement in the first instance and the sale thereafter, and the cost of improvements and development, if any.

Sale of Property Acquired by Gift or Bequest.—The basis for determining gain or loss on a sale of property acquired by gift, bequest, devise, or descent is the fair market price or value

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of such property on the date of acquisition or as of March 1, 1913, if acquired prior thereto. For the purpose of determining the profit or loss from the sale of property acquired by bequest, devise or descent, since February 28, 1913, its value as appraised for the purpose of the Federal estate tax, or in the case of estates not subject to that tax, its value as appraised in the state court for the purpose of state inheritance taxes, should be deemed to be its fair market value when acquired.

Exchanges of Property.—Gain or loss arising from the acquisition and subsequent disposition of property is realized when, as the result of a transaction between the owner and another person, the property is converted into cash or into property that is essentially different from the property disposed of and that has a market value. A change in substance and not merely in form, and a change into the equivalent of cash are required to complete or close a transaction from which income may be realized. Thus, if a man owning ten shares of listed stock exchanges his stock certificate for a voting trust certificate, no income is realized, the conversion being merely in form. If, however, he exchanges his stock for a Liberty bond, income may be realized because the conversion is into independent property having market value. The property received in exchange may be real estate, personal property, or a chose in action. The exchange of a so-called convertible bond for stock, pursuant to such a privilege granted in the bond, will produce income if the stock received in exchange has a fair market value in excess of the cost or fair market value as of March 1, 1913, of the bond.

Determination of Gain or Loss from Exchange of Property.—The amount of income derived in the case of an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the bond received in exchange over the original cost of the stock exchanged for it, or over the fair market price or value of such stock as of March 1, 1913, if acquired prior thereto. The amount of income derived from a subsequent sale of the bond for cash is the excess of the amount so received over the fair market value of such bond when acquired in exchange for the stock. On the other hand, if the property received in exchange is substantially the same property or has no market value, then no gain or loss is realized, but the new property is to be regarded as substituted for the old, and upon a

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sale of the new property the amount of income derived is the excess of the amount so received over the cost or fair market value as of March 1, 1913, of the old.

Exchange of Different Kinds of Property.—If property is exchanged for two different kinds of property, such as bonds and stock, the bonds having a market value and the stock none, the value of the bonds is to be compared with the cost, or fair market value as of March 1, 1913, of the original property, as the case may be. If the market value of the bonds is less than such cost or value, the difference represents the cost of the stock. If the market value of the bonds is greater than such cost or value, the difference is taxable income at the time of the exchange, and whenever sold, the entire proceeds of the stock will be taxable.

If property is exchanged for two different kinds of property, such as bonds and stocks, neither having a market value, the cost or fair market value as of March 1, 1913, of the original property should be apportioned, if possible, between the bonds and the stocks for the purpose of determining gain or loss on subsequent sales. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sales there shall have been recovered the entire cost or fair market value as of March 1, 1913, of the original property.

Exchange of Property for Stock.— Where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction and the former owner of the property realizes a gain or loss if the stock has a market value, and such market value is greater or less than the cost or the fair market value as of March 1, 1913, (if acquired prior thereto) of the property given in exchange. Stock is to be regarded as ordinarily having a market value, even though no actual market for it can be established. In this sense, therefore, market value may be regarded as the price which might reasonably be presumed would be agreed upon between a willing buyer and a willing seller.

Exchange of Stock for Other Stock of No Greater Par Value.—Treasury Decision 2924, dated September 26, 1919, has amended Article 1567, of Regulations 45 so as to provide as follows:

In general, where two (or more) corporations unite their properties by either (a) the dissolution of corporation B and the sale of its assets to corporation A, or (b) the sale of its property by B to A

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and the dissolution of B, or (c) the sale of the stock of B to A and the dissolution of B, or (d) the merger of B into A, or (e) the consolidation of the corporations, no taxable income is received from the transaction by A or B or the stockholders of either, provided the sole consideration received by B and its stockholders in (a), (b), (c), and (d) is stock or securities of A, and by A and B and their stockholders in (e) is stock or securities of the consolidated corporation, in any case of no greater aggregate par or face value than the old stock and securities surrendered. The term "reorganization," as used in Section 202 of the statute, includes cases of corporate readjustment where stockholders exchange their stock for the stock of a holding corporation, provided the holding corporation and the original corporation, in which it holds stock, are so closely related that the two corporations are affiliated as defined in Section 240 (b) of the statute and Article 633 of Regulations 45, and are thus required to file consolidated returns. So-called "no-par-value stock" issued under a statute or statutes which require the corporation to fix in a certificate or on its books of account or otherwise an amount of capital or an amount of stock issued which may not be impaired by the distribution of dividends, will for the purpose of this section be deemed to have a par value representing an aliquot part of such amount, proper account being taken of any preferred stock issued with a preference as to principal. In the case (if any) in which no such amount of capital or issued stock is so required, "no-par-value stock" received in exchange will be regarded for purposes of this section as having in fact no par or face value, and consequently as having "no greater aggregate par or face value" than the stock or securities exchanged therefor.

Determination of Gain or Loss from Subsequent Sale.—The new stock and securities received as described in the preceding paragraph take the place of the old stock and securities. For the purpose, therefore, of ascertaining the gain derived or loss sustained from the subsequent sale of any stock of A or of the consolidated corporation so received, the original cost to the taxpayer or the fair market value as of March 1, 1913, of the stock of B or A in respect of which the new stock was issued, less any untaxed distribution made to the taxpayer by A out of the former capital or surplus of B, or by the consolidated corporation out of the former capital or surplus of A or B, is the basis for determining the amount of such gain or loss. Similarly, the cost after reorganization, merger, or consolidation of the assets of A or of the consolidated corporation

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is the sum of the cost (or the fair market value as of March 1, 1913) of the assets of A and of B for the purpose of ascertaining the gain or loss upon a subsequent sale. The new invested capital of A or of the consolidated corporation is to be determined as if A and B were rendering a consolidated return as affiliated corporations.

Exchange of Stock for Other Stock of Greater Par Value.—If in the case of any reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock and securities exchanged, income will be realized from the transaction by the recipients of the new stock or securities to an amount limited by (a) the excess of the par or face value of the new stock or securities over the par or face value of the old and (b) the excess of the fair market value of the new stock or securities over the cost or fair market value as of March 1, 1913, of the old. In other words, the taxable profit will be (a) or (b), whichever is less. Upon a subsequent sale of the new stock or securities their cost to the taxpayer will be the cost or fair market value as of March 1, 1913, of the old stock and securities, plus the profit taxed on the exchange.

Readjustment of Partnership Interests.—When a partner retires from a partnership, or it is dissolved, he realizes a gain or loss measured by the difference between the price received for his interest and the cost to him, or if acquired prior to March 1, 1913, the fair market value as of that date, of his interest in the partnership, including in such cost or value the amount of his share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid. If, however, the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received on distribution. Whenever a new partner is admitted to a partnership, or any existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next income tax return in order that the Commissioner may determine whether any gain or loss has been realized by any partner.

GROSS INCOME

In General

Except for certain special provisions relating to insurance companies, the gross income of an individual, fiduciary, partnership, or

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corporation include all gains, profits, and income derived from

(1) salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid;

(2) professions, vocations, trades, businesses, commerce, or sales;

(3) dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property;

(4) interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit; and

(5) income derived from any source whatever, not specifically made exempt.

The law specifically excludes certain other items from gross income which will be found under the caption of "Exempt Income."

When Income Should Be Reported.—All items of gross income must be included in the return of income for the taxable year in which received, unless included when they accrue under certain specified methods of accounting heretofore mentioned.* In view of the unusual conditions prevailing at the close of the year 1918, the Department has recognized that many items of gross income, such as claims for compensation under cancelled contracts, together with claims against contracting departments of the Government for amortization and other matters, while properly constituting gross income for the year 1918, were undecided and not sufficiently definite in amount to be reported in the original return for that year. In such cases the taxpayer should have attached to his return a full statement of such pending claims and other matters, and when the correct amount of these items is ascertained an amended return for that year should be filed.

A person may sue in one year upon a pecuniary claim or for property, but money or property recovered on a judgment therefor rendered in a later year would be income in that year, assuming that it would have been income in the earlier year if then received. This is true of a recovery for patent infringement. Bad debts or accounts charged off because deemed to be worthless and subsequently recovered by suit or otherwise, represent income for the year in which recovered, irrespective of when the amounts were charged off.

Actual and Constructive Receipt.—Income may be received by a taxpayer in two ways, namely, by actual receipt or constructive receipt. The former is had when income is reduced to possession; the latter when income is credited or made available to the recipient, as in the case of interest on bank deposits which is

*See page 31.

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credited to the depositor's account. In either case the amount received or credited must be returned as income unless it comes within one of the classes of exempt income.

Items of income need not be actually reduced to possession to become subject to tax. Income credited to the account of or set apart for a taxpayer, and which may be drawn against by him at any time, is subject to tax for the year during which so credited or set apart. In order to constitute receipt it is necessary in such cases for the income to be credited without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and where book entries are made they should indicate an absolute transfer from one account to another. If the income is not credited, but is merely set apart, it must be unqualifiedly subject to the taxpayer's demand before it acquires the status of taxable income. Therefore, where a corporation contingently credits its employees with bonus stock, the latter not becoming available to the employees until the end of five years of employment, the mere crediting on the books of the corporation does not constitute receipt by the employees.

Where interest coupons mature, but are not cashed, the interest payment is available to the taxpayer and must be included in his return for the year in which the coupons mature, even though they are later exchanged for other property instead of eventually being cashed. The fact that it was impracticable to cash the coupons for any reason does not alter the rule. Interest credited on savings bank deposits, even though the bank nominally has a rule that it may require so many days' notice in advance of cashing depositors' checks, is income to the depositor when credited. An amount credited to shareholders of a building and loan association, when such credit passes without restriction to the latter, represents taxable income for the year of the credit, but where the amount of such accumulation is not available to the shareholder until the maturity of the share, the amount of any share in excess of the original amount paid in by the shareholder, is taxable income for the year of the maturity of the share.

Medium of Payment.—The form of payment is immaterial in determining whether or not income has been received by the taxpayer, services especially being frequently compensated for with securities or something else, the value of which is ascertainable in terms of money. Thus, where services are rendered for a stipulated price and paid for with something other than money, the stipulated

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value of such services in terms of money is the value at which the thing taken in payment is to be considered for the purpose of determining the income received, the stipulated price, in the absence of evidence to the contrary, being presumed to be the fair value of the compensation received. If there is no stipulation as to the value of the services and the payment is made with something other than money, the fair market value of the thing received in payment is the amount to be included as income by the recipient.

Payment in Tax-Exempt Securities.—Payments of income made in Liberty Bonds or other obligations of the United States, or of a state, or in other securities, whether or not tax-exempt, must be included in the gross income of the taxpayer as though made in cash, the security assuming the character of cash by reason of its use as a medium of payment.

Promissory Notes as Payment.—A promissory note received in settlement of an account is in effect a payment of such account, and so much of the amount of the note as represents net income is subject to tax for the year in which received. Promissory notes received in payment for services, and not merely as security therefor, represent income to the amount of their fair market value. A taxpayer receiving as compensation a note regarded as good for its face value at maturity, but not bearing interest, may properly treat as income as of the time of receipt the fair discounted value of the note at such time. Thus, if it appears that such a note is or could be discounted on a six or seven per cent. basis, the recipient may include it in his gross income to the amount of the face value, less discount computed at the prevailing rate for such transactions. If the payments due on a note so accounted for are met as they become due, there should be included as income in respect of each such payment so much thereof as represents recovery for the discount originally deducted.

Income From Personal Services

In general, income from personal services includes all salaries, wages, commissions, bonuses, fees, and compensation of whatever kind and in whatever form paid, unless specifically exempt from tax.

The form in which the compensation is paid is immaterial. Compensation paid to an employee of a corporation in its stock is to be treated as though the corporation sold the stock for its market value, and paid the employee in cash. Where an employer, for his own convenience, furnishes to his employees, living quarters such

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as camps, the ratable value need not be added to the cash compensation of the employee, but where a person receives a salary as compensation for services and also living quarters, the value of the quarters constitutes taxable income. If the employer, in addition to paying a salary, agrees with an employee to furnish him with room and board, the employee should place a fair rental value upon the room and a fair value upon the meals furnished, and these amounts should be reported as income. Premiums paid by an employer on life, accident or health insurance policies in favor of his employees as additional compensation, are income to the employees.

Treatment of Compensation.—Compensation is the purchase price of services and must compensate not only in form but in fact. It is in general just to assume that reasonable and true compensation ordinarily means only such as would be paid for like services, by like enterprises, in like circumstances. The circumstances to be taken into consideration are those existing when the contract for services was made; not those existing when the contract is questioned. While, any form of contingent compensation invites scrutiny as a possible distribution of earnings, it does not follow that payments on a contingent basis are to be treated fundamentally on a basis different from that applying to compensation paid at a flat rate. Generally speaking, if contingent compensation is paid in pursuance of a free bargain between the enterprise and the individual, made before the services are rendered, not influenced by any consideration on the part of the employer, except that of securing on fair and advantageous terms, the services of the individual, it should be allowed as a deduction, even though in the actual working out of the contract it may prove greater than the amount which would ordinarily be paid.

In case of a corporation with a limited number of stockholders, practically all of whom draw salaries which are based upon or bear a close relationship to the stockholdings of the officers or employees, it would seem that such salaries, if in excess of those ordinarily paid for similar services, are not paid wholly for services rendered, but partly as a distribution of earnings upon the stock. The amount of excess in such cases should be treated as dividends, which would be subject only to the surtax in the hands of the recipients. In the case of a corporation controlled by salaried employees by reason of their holding directly or indirectly a majority of its stock, or in the case of a large corporation with many stockholders owning a substantial minority of its stock, the tendency of

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the officers to unduly inflate their salaries must be considered. If so-called payments of salaries represent an appropriation of assets of the corporation by officers, who control it and fix their compensation in violation of the rights of the corporation, they should be treated as compensation of the individuals subject to the normal tax, the fact that they are illegally secured not affecting their status as income.

An ostensible salary may be in part payment for property. This may occur where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the latter. In such a case, it may be found that the salaries paid the former partners are not merely for services, but in part constitute a payment for the transfer of their business. In the case of excessive payments by individuals or partnerships, amounts disallowed should ordinarily be treated as shares of the profits of a partnership, except that a payment for property should be treated by the individual or partnership as a capital expenditure and by the recipient as part of the purchase price.

Time of Reporting Compensation.—Where no determination of compensation is had until the services are completed the amount received is income for the year of its determination.

Where an employee receives only part of the salary due him during the year because of the fact that his employer is in financial straits, and in a subsequent year receives his salary in full, together with the balance owing him on account of the previous year, he must report the back salary as income as of the year of its receipt. It is otherwise if the recipient's books are kept on an accrual basis, or if the salary owing him for prior years and not then received was credited to him by the employer and treated by him as income in his return for such years. In this connection, income credited or made available to the taxpayer, as heretofore stated, constitutes a constructive receipt by him and must be returned as income for the year in which credited or made available to him. Accordingly, if a person paid on a commission basis, earns $10,000 during the taxable year which is credited to him, against which only $4,000 has been withdrawn by him, he must report the full amount credited during the year, namely $10,000.

Bonuses.—So-called bonuses, or sums paid in addition to the stipulated salaries or wages of employees, constitute taxable income when made in good faith and as additional compensation for services actually rendered by the recipients. If the bonus is not compen-

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sation for services rendered but a pure gift or gratuity on the part of the employer without any element of compensation, or if it exceeds reasonable compensation for the services rendered, it is not taxable in the hands of the recipient and cannot be deducted by the employer as an expense of the business.

Compensation of Federal Officers and Employees.—The compensation derived from office by the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, is subject to tax. Salaries of officers or employees of a state or any political subdivision thereof are also subject to tax when paid by the United States Government.

Mass Offerings, Fees, Tips, etc.—Marriage fees, Easter and baptismal offerings, sums paid for saying Masses for the dead and similar amounts received by clergymen and others for services rendered, represent taxable income, but Christmas gifts to such persons are not taxable, being regarded as pure gratuities and not as compensation for services rendered. Tips to waiters, porters, and others are regarded as given in consideration of services rendered and should therefore be reported as income by the recipients.

Commissions.—Commissions paid to salesmen, compensation for services on the basis of a percentage of the net profits of a business, commissions paid to real estate agents for managing or renting property, commissions paid on insurance premiums and other commissions, not expressly exempt, are subject to tax.

Compensation of Trustees.—Fees or other compensation of trustees, executors, administrators, and other persons acting in a fiduciary capacity must be reported as income for the year in which received, and where the amount due the fiduciary for his services for a period of years is not determined until the trust is terminated, the amount of his compensation must be returned in full, subject to allowable deductions, as income for the year in which paid and cannot be prorated over the period of his trusteeship.

Pensions.—Retired allowances or pensions paid by the United States, private institutions or private individuals, but not those paid by states, are regarded as compensation for past services rendered and are taxable as such.

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Income from Trade, Business, or Commerce

Mercantile Business.—The gross income from a mercantile or merchandising business includes in general the total sales during the year, less the cost of goods sold, plus any income that may be derived from investments and from incidental or outside operations or sources. The gross income is actually ascertained by deducting from the total sales during the year and the income from incidental and outside operations the net cost of goods sold. The net cost of goods sold is obtained by adding the cost of labor upon the goods, the cost of materials and supplies, the cost of merchandise bought for sale, and other costs properly chargeable against the goods (not including business deductions) to the inventories at the beginning of the year, and deducting therefrom the inventories at the end of the year. No subtractions should be made in determining gross income, for depreciation, depletion, selling expenses or losses, or for items not ordinarily used in computing the cost of goods sold. These must be taken as deductions in the return in ascertaining net income. The taxpayer must include also all amounts received as allowance for amortization from whatever source and by whatever name called, since the allowance authorized by the law must be taken by way of a deduction from gross income. Therefore, if any allowance to the taxpayer is made by a contracting department of the Government, or by any other contractor for amortization or fall in the value of the property, either as part of the cost of production or as a part of the price of the product, such allowance must be included in the gross income of the taxpayer and deduction taken in the proper manner in the return.

Manufacturing and Mining Business. — The gross income of a manufacturing or mining business is in general the same as that of a mercantile or merchandising business and consists of the total sales, less the costs of goods sold, plus any income from investments and from incidental or outside operations or sources. The income is arrived at in substantially the same manner as in the case of a mercantile business and in accordance with the methods prescribed in Forms 1040, Revised, and 1120. Finished and unfinished products and raw materials must be taken into consideration in the inventory in arriving at the gross income.

Miscellaneous Corporations.—The gross income of miscellaneous corporations consists of the total revenue derived from the operation and management of the business and property, to-

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gether with all income from other sources. Corporations carrying on more than one class of business should include in their returns the gross income from all enterprises in which they are engaged.

Contracting Business.—Persons engaged in a contracting business, who have uncompleted contracts which may run for periods of several years may prepare their returns so that the gross income will be ascertained on the basis of completed work; that is, on jobs which have been finally completed, any amounts received in payment will be returned as income for the year in which the work was completed. If the gross income is ascertained in this way, the deductions should be limited to the expenditures made on account of such completed contracts. If he chooses, the taxpayer may estimate the percentage of profits from the contract on the basis of the percentage of completion, in which case the income returned each year during the performance of the contract will be computed upon the basis of the expenses incurred on the contract during the year. Thus, if one-half of the estimated expenses necessary to the full performance of the contract are incurred during one year, one-half of the gross contract price should be returned as income for that year. If, when the contract is completed, it is found that as a result of the estimate or apportionment, the income of any year has been overstated or understated, the taxpayer should file an amended return for such year or years.

Where a contractor enters into a contract during one year which will not be completed until the following year, and the contractor is required to make expenditures for material and labor, and to provide for possible losses, he may either include in gross income the advance payments received during the first year, or await the completion of the contract before reporting amounts received. If the second method is followed the expenses will not be charged until the completion of the contract.

Banks and Other Financial Institutions.—Gross income of banks and other financial institutions consists of the total revenue derived during the year from operation of the business, including gains or profits from the sale of capita assets and from all other sources.

Exporting Business.—A tax on the net income of an exporting business is not a tax laid on articles in the course of exportation or on anything which inherently or by the usages of commerce is

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embraced in exportation or any of its processes, but is a tax on income levied after exportation is completed, after all expenses are paid and losses are adjusted, and after the recipient is free to use the income as he chooses, and such tax, therefore, is not unconstitutional. Accordingly, profits on all sales in foreign commerce are held to represent taxable income.

Income from Sales or Dealings in Property

All income from sales, exchanges, or other dealings in property is subject to tax and must be included in the return of the recipient for the year in which received. The rules for determining the amount of gain or loss derived from such transactions will be found under the caption "Basis for Determining Gain or Loss."

Sale of Shares of Stock.—When shares of stock in a corporation are sold from lots purchased at different times and at different prices, and the identity of the lots cannot be determined, the stock sold should be charged against the earliest purchases of such stock. Whenever possible the numbers of the certificates should be identified. The excess of the amount realized on the sale over the cost or the fair market value of the stock as of March 1, 1913, if acquired prior thereto, will be the profit to be accounted for as income. In the case of stock received as a stock dividend, whether or not paid out of earnings or profits accrued since February 28, 1913, and in the case of stock in respect of which any such dividend was paid, the cost of each share should be ascertained in accordance with the method described on page 61.

The entire amount realized from the sale of rights to subscribe for stock is income for the year in which such rights are sold.

Sale of Capital Stock by a Corporation.—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital and not the income of the company. If such stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a deductible loss, no gain or loss being realized by the corporation from the purchase or sale of its own stock. If for any other purpose, stockholders donate or return to the corporation certain shares of the capital stock previously issued to them, and they are resold by it, or if the corporation purchases any of its

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stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of the sale will be treated as capital and not as income of the corporation.

Sale of Capital Assets.—Where a corporation sells its capital assets in whole or in part, it must include in its gross income for the year in which the sale is consummated the amount of the excess of the sales price over the cost of the assets or their fair market value as of March 1, 1913, if acquired prior thereto. In every case, however, in ascertaining the gain or loss, the cost of the assets or the fair market value as of March 1, 1913, of the assets acquired prior thereto, should first be reduced by the amount of any charges for depreciation, depletion, and other losses which have been or should have been made. If the purchaser takes over the assets and assumes the liabilities the amount so assumed is part of the purchase price. If the sale is made for stock or bonds of another corporation the rules governing exchanges of property will apply.

Appreciation in the Value of Assets.—Appreciation in the value of assets due to appraisal or adjustment and taken up on the books of an individual or corporation is not income until as the result of a completed or closed transaction the assets are converted into cash or its equivalent. Such an appreciation is intangible and unstable, and is not such income as the law contemplates shall be returned for purposes of the tax.

Sale of Patents and Copyrights.—A taxpayer disposing of patents or copyrights by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the value as of March 1, 1913, if acquired prior to that date, or between the selling price and the cost, if acquired after that date. The profit or loss thus ascertained should be increased or decreased, as the case may be, by the amounts deducted on account of depreciation of such patent or copyright since February 28, 1913, or since the date of acquisition if subsequent thereto. If the patent was acquired from the Government, its cost will consist of the various Government fees, cost of drawings, experimental models, attorney's fees, etc., actually paid. If a corporation purchased a patent and paid for it in stock or securities, its cost is the fair market value of the stock or securities at the time of the purchase. Depreciation of a patent can be taken on the basis of the

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fair market value as of March 1, 1913, only when affirmative and satisfactory evidence of such value is offered, which, whenever practicable, should be submitted with the return.

Sale of Good Will.—Profit or loss resulting from an investment in good will can be taken only when the business, or a part of it to which the good will attaches is sold, in which case the profit or loss will be determined upon the basis of the cost of the assets, including good will, or their fair market value as of March 1, 1913, if acquired prior thereto. If nothing was paid for good will acquired after February 28, 1913, no deductible loss is possible, although, on the other hand, upon the sale of the business there may be a profit. It is immaterial that good will may never have been carried on the books as an asset, but the burden of proof rests upon the taxpayer to establish the cost or fair market value on March 1, 1913, of the good will sold.

Sale and Retirement of Corporate Bonds.—If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. If the corporation later purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price, minus any amount of premium already returned as income, the excess of the purchase price over the issuing price, minus any amount of premium already returned as income (or over the face value, plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price, minus any amount of premium already returned as income, the excess of the issuing price, minus any amount of premium already returned as income (or of the face value, plus any amount of premium not yet returned as income) over the purchase price is gain or income for the taxable year.

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If bonds are issued by a corporation at a discount, the net amount of such discount is deductible as interest and should be prorated or amortized over the life of the bonds. If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price, plus any amount of discount already deducted, the excess of the purchase price over the issuing price, plus any amount of discount already deducted (or over the face value, minus any amount of discount not yet deducted) is a deductible expense for the taxable year. If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price, plus any amount of discount already deducted, the excess of the issuing price, plus any amount of discount already deducted (or of the face value, minus any amount of discount not yet deducted) over the purchase price is gain or income for the taxable year.

Sale of Personal Property on Installment Plan.—Dealers in personal property ordinarily sell either for cash, or on the personal credit of the buyer, or on the installment plan. Occasionally, a fourth type of sale is met, in which the buyer makes an initial payment of such a substantial nature (for example, a payment of more than twenty-five per cent) that the sale, though involving deferred payments, is not one on the installment plan. In sales on personal credit, and in sales of the substantial payment type above referred to, obligations of the purchasers are to be regarded as the equivalent of cash, but a different rule is applicable to sales on the installment plan. Dealers in personal property, who sell on the installment plan, usually adopt one of four ways of protecting themselves in case of default:

(a) through an agreement that title is to remain in the seller until the buyer has completely performed his part of the transaction;

(b) by a form of contract in which title is conveyed to the purchaser immediately, but subject to a lien for the unpaid portion of the purchase price;

(c) by a present transfer of title to the purchaser, who at the same time executes a reconveyance in the form of a chattel mortgage to the seller; or

(d) by conveyance to a trustee pending performance of the contract and subject to its provisions.

The general purpose and effect is the same in all of the above plans, and the Department has ruled that in the sale or contract for sale of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for,

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the income to be returned by the vendor will be that proportion of each installment payment which the gross profit to be realized when the property is paid for bears to the gross contract price.

The income may be ascertained by taking that proportion of the total payments received in the taxable year from installment sales (always including payments received in the taxable year on account of sales effected in earlier years, as well as those effected in the taxable year) which the gross profit to be realized on the total installment sales made during the taxable year bears to the gross contract price of all such sales made during the taxable year. Where a change is made to this method of computing net income the taxpayer's balance sheet should be adjusted conformably as of the date when the change is effected. If for any reason the vendee defaults in any of his installment payments and the vendor repossesses the property, the entire amount received on installment payments, less the profit already returned, will be income of the vendor for the year in which the property was repossessed, and the property repossessed must be included in the inventory at its original cost to himself, less proper allowance for damage and use, if any. If the vendor chooses, as a matter of consistent practice, to treat the obligations of purchasers as the equivalent of cash, such method is permissible.

Where an installment house makes sales which are not on the installment plan, the profit on such completed sales is determined in the ordinary manner.*

Sale of Real Estate in Lots.—Where a tract of real estate is purchased with a view to dividing it into lots or parcels of ground to be sold as such, the entire fair market value as of March 1, 1913, or the cost if acquired after that date, must be equitably apportioned to the several lots or parcels and made a matter of record in the books of the taxpayer in order that any gain derived from the sale of any such lots or parcels may be returned as income for the year in which the sale was made. This rule contemplates that there will be a measure of gain or loss in every lot or parcel sold, and not that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain or loss will be accounted for accordingly.

Sale of Real Estate Involving Deferred Payments.—Deferred payment sales of real estate ordinarily fall into two classes when considered with respect to the terms of sale, as follows:

* See page 35.

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(1) Installment transactions, in which the initial payment is relatively small (generally less than one-fourth of the purchase price) and the deferred payments usually numerous and of small amount. They include:

(a) sales where there is immediate transfer of title when a small initial payment is made, the seller being protected by a mortgage or other lien as to deferred payments, and (b) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the installments have been paid.

(2) Deferred payment sales not on the installment plan, in which there is a substantial initial payment (ordinarily not less than one-fourth of the purchase price), deferred payments being secured by a mortgage or other lien. Such sales are distinguished from sales on the installment plan by the substantial character of the initial payment and also usually by a relatively small number of deferred payments.

In determining how these classes shall be treated in levying the income tax, the question in each case is whether the income to be reported for taxation shall be based only on amounts actually received in a taxing year, or on the entire consideration made up in part of agreements to pay in the future.

Sale of Real Estate on Installment Plan.—In the two kinds of transactions included in class (1) in the preceding paragraph, installment obligations assumed by the buyer are not ordinarily to be regarded as the equivalent of cash, and the vendor may report as his income from such transactions in any year that proportion of each payment actually received in that year which the gross profit to be realized when the property is paid for bears to the gross contract price. If the return is made on this basis and the vendor repossesses the property after default by the buyer, retaining the previous payments, the entire amount of such payments, less the profit previously returned, will be income to the vendor and will be so returned for the year in which the property was repossessed, and the property repossessed must be included in the inventory at its original cost to himself, less any depreciation. If the taxpayer chooses as a matter of settled practice consistently followed to treat the obligations of the purchaser as equivalent to cash and to report the profit derived from the entire consideration, cash and deferred payments, as income for the year when the sale is made, this is permissible. If so treated, the rule referred to in the next paragraph will apply.

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Deferred Payment Sales of Real Estate Not on Installment Plan.—In class (2) in the second preceding paragraph the obligations assumed by the buyer are much better secured because of the margin afforded by the substantial first payment, and experience shows that the greater number of such sales are eventually carried out according to their terms. These obligations for deferred payments are therefore to be regarded as equivalent to cash, and the profit indicated by the entire consideration is taxable income for the year in which the initial payment was made and the obligations assumed. If the buyer defaults and the seller regains title to the land by agreement or process of law, retaining payments previously made, he may deduct from his gross income as a loss in the year of repossession any excess of the amount previously reported as income over the amount actually received, and must include such real estate in his inventory at its original cost to himself, less any depreciation allowed.

Income from Interest

All interest, including interest on bank deposits, accounts current, bonds, mortgages and other evidences of indebtedness, together with interest from miscellaneous sources, received by a taxpayer and not specifically exempt, must be reported as income for the year in which received, unless some other approved method of accounting is employed, permitting a return on an accrual basis.

Bond Interest.—All interest on bonds, notes, mortgages, or other interest-bearing obligations of residents, corporate or otherwise, must be included in the return of the recipient, even though the debtor corporation is specifically exempt from income tax. The fact that an interest coupon for any reason is not cashed when it matures, as before stated, does not relieve the recipient from the necessity of reporting the interest payment for the year in which due and payable, even though the coupons are later exchanged for other property instead of being cashed. If the coupons bear a date prior to March 1, 1913, but are not presented for payment until a later year, whether or not funds were on hand to meet them at maturity, they are not subject to tax, since they represent income due and payable and which could have been reduced to possession on demand prior to the incidence of the Federal income tax.

"Tax-free" Bonds.—The Department has ruled that the amount of income tax paid for a bondholder by an obligor or debtor

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corporation, pursuant to a "tax-free" covenant in its bonds, is in the nature of additional interest paid such bondholder and must be included in his gross income.

Obligations of the United States.—Interest on obligations of the United States issued after September 1, 1917, is subject to surtax, and to war profits and excess profits taxes, except to the extent made exempt in the various Acts authorizing their issue.*

War Finance Corporation Bonds.—Interest on bonds issued by the War Finance Corporation is exempt from the individual normal tax and the corporation income tax, but is exempt from the surtax and war profits and excess profits taxes, only to the extent provided in the War Finance Corporation Act of April 5, 1918, namely, the income on a principal of $5,000 face value. Interest on the excess of that amount must be reported as income, being subject to surtax and war profits and excess profits taxes.

Railroad Administration Certificates and Food Administration Grain Corporation Notes.—The interest on United States Railroad Administration certificates, issued April 3, 1919, and the interest on Food Administration Grain Corporation notes are subject to Federal income and war profits and excess profits taxes.

Bonds Purchased Between Interest Dates.—Where bonds are purchased with accrued interest, the owner at the time the interest became due and payable should account in his return only for the interest which accrued after the bonds were purchased and not for the entire proceeds of the coupons. The former owner should account in his return for interest which accrued during his ownership of the bonds.

Bond Interest Received by Legatees.—A legatee should return as income the full amount of interest received by him on a bond, even though part of the first coupon payable after he received it has been added to the bond and included in the gross estate of the decedent, thereby becoming subject to the Federal Estate Tax Law.

Income from Rents and Royalties

Income from rents and royalties is subject to tax and must be included in the income tax return for the year in which received, unless the taxpayer's books are kept on some other approved basis.

* See page 67

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All sums paid by a tenant for the use of property, even though to a person other than the landlord, are to be regarded as rent and constitute income of the landlord. Board, lodging or other consideration received in lieu of rental is considered income equal in amount to the indebtedness in payment of which it is received. Amounts expended by tenants for taxes and necessary repairs under agreement, in addition to a stipulated cash rental, must be included as income in the return of the landlord, who may deduct a corresponding amount as taxes paid or for repairs on rented property.

Permanent Improvements.—Where a tenant under the terms of a rental or lease contract agrees to erect a building or to expend during the period of his term a fixed sum in making improvements upon the freehold of another, the buildings or improvements are held to become a part of the realty unless otherwise agreed between the contracting parties, and accordingly must be returned as income by the lessor in the value of his realty at the termination of the contract, whether terminated by the expiration of the lease or otherwise. The lessor's gain at the termination of the lease will be the difference between the cost of the buildings or improvements and a reasonable allowance for exhaustion, wear and tear of the property, arising out of its use in the business or trade during the period of its life under the lease, no annual deduction for depreciation being allowed during the lease term. Since the use by the tenant during the term of the lease is a part of the consideration, the cost may be prorated by the tenant over the lease term and deducted at an annual rate as a part of the necessary expenses, together with the costs of incidental repairs and maintenance.

Royalties.—The term "royalties" includes all payments made to a proprietor by those whom he allows to develop or use his property or operate under some right belonging to him. Payments to an inventor for the use of his patent, or to an author as his share of the profits of a book, or to a mine owner for the privilege of developing and working his mineral property, all represent taxable income and as such must be included in the return of the recipient for the year in which received, unless properly accounted for as of a different period in accordance with some other approved method of accounting.

Royalties from Patent Rights.—Royalties received in accordance with a contract by which the owner of a patent assigns the right to manufacture machines are income to the recipient and are

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to be accounted for as such. The owner of a patent may deduct from gross income each year, until the capital invested therein is extinguished, a sum ascertained by dividing the cost of the patent by the number of years constituting its life, or by a number representing the years of its life remaining after the date of acquirement. Where an inventor makes a contract whereby he agrees to sell to another the right to manufacture and dispose of a patented machine, in consideration of the payment of a stipulated sum for each machine sold, the amounts received by him represent taxable income. Where the entire rights are sold for a lump sum to a third party, his rights under the above contract being included, the difference between the lump sum so received and the aggregate amount expended by him in perfecting the invention and obtaining the patent are income for the year in which received.

Income from Dividends

The term "dividend" means any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation, other than a personal service corporation, to its shareholders or members, whether in cash or in other property or in stock of the corporation, out of its earnings or profits accumulated since February 28, 1913, or any such distribution made by a personal service corporation out of its earnings or profits accumulated since February 28, 1913, and prior to January 1, 1918. Profits accumulated prior to March 1, 1913, are not included in the term "dividend" and should be excluded from the gross income of a taxpayer, since they are not subject to tax. A distribution out of assets other than earnings or profits accumulated since February 28, 1913, may or may not be free from tax, according as each stockholder receives more or less than he paid for his stock or its fair market value as of March 1, 1913, if acquired prior thereto. In determining whether a distribution is made out of earnings or profits accumulated before or after March 1, 1913, due consideration must be given to the facts in the case, and mere book entries increasing or decreasing the surplus of the corporation are not conclusive.

Taxable Status.—Dividends are income and are taxed for the year in which paid, namely, when set apart for a stockholder, regardless of when he collects them and regardless of when the earnings or profits out of which they were paid were accumulated by the corporation. Stock dividends are an exception to this rule.

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Although interest on state or municipal bonds and certain other obligations is not taxable when received by a corporation, such income, upon amalgamation with other funds of the corporation, loses its identity and when distributed to stockholders in the form of dividends is taxable to the same extent as dividends from other sources.

Dividends of domestic or resident corporations, and dividends of foreign corporations paying a Federal income tax upon their net income, are subject to surtax only. The fact that the income of a foreign corporation derived from sources within the United States is small does not alter the situation, since if any income is derived from sources in this country, no matter how small, and tax is paid thereon, the dividends will be subject only to the surtax.

Dividends of nonresident foreign corporations, namely, those not paying any Federal income tax, are subject to both the normal tax and surtax when received by citizens or residents of the United States, but not when received by nonresident aliens; and this is true even though the dividends are paid by a disbursing agent of the nonresident corporation in the United States.

Dividends on Life Insurance Policies.—Dividends on life insurance policies that have not matured, whether paid in cash or added to the face value of the policy, are not items of taxable income, but dividends on paid-up policies are taxable income and subject to the surtax the same as any other dividends.

Liquidation Distributions.—So-called liquidating or dissolution dividends are not dividends within the meaning of the law, and amounts so distributed, whether or not including any surplus earned since February 28, 1913, are to be regarded as payments for the stock of the dissolved corporation. Any excess received over the cost of the stock to a stockholder, or over its fair market value as of March 1, 1913, if acquired before that date, is a taxable profit.

A distribution in liquidation of the assets and business of a corporation, which is a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation, is distinguishable from a dividend paid by a going corporation out of current earnings or accumulated surplus when declared by the directors in their discretion, being is in the nature of a recurrent return upon the stock.

Distribution from Depletion or Depreciation Reserves.—A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital

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assets on account of depletion or depreciation, is not a part of its surplus out of which ordinary dividends may be paid. A distribution made from such a reserve will be considered a liquidating dividend and will be taxable to a stockholder only to the extent that the amount so received exceeds the cost or fair market value as of March 1, 1913, of his shares of stock. No distribution, however, will be deemed to have been made from such a reserve, except to the extent that the amount paid exceeds the surplus and undivided profits of the corporation.

Presumption as to Source of Distribution.—In the case of a corporation other than a personal service corporation, any distribution to stockholders is deemed to have been made, so far as possible

(a) from earnings or profits;
(b) during the year 1918 or thereafter, from earnings or profits accumulated since February 28, 1913;
(c) if during the first sixty days of a taxable year, from earnings or profits accumulated during preceding taxable years; and
(d) if during the remainder of a taxable year after the first sixty days, from earnings or profits accumulated during the taxable year up to the date of distribution.

If the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made is deemed to have been accumulated ratably during such period. The presumption contained in clauses (c) and (d) affects the determination of invested capital for the purpose of the war profits and excess profits tax, but has no effect upon the rates at which dividends paid in 1918 and subsequent years are taxed. In ascertaining whether or not a distribution was made out of earnings or profits of the taxable year there should first be set aside a proper reserve for the payment of accrued income and war profits and excess profits taxes.

In the case of a personal service corporation any distribution is deemed to have been made so far as possible

(a) from earnings or profits;
(b) during the year 1918 or thereafter, from earnings or profits accumulated since February 28, 1913.
(c) if during the first sixty days of a taxable year, from the most recently accumulated earnings or profits of preceding taxable years and
(d) if during the remainder of the taxable year after the first sixty days, from earnings or profits accumulated during the taxable year up to the date of distribution.

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Dividends Paid in Securities or Other Property.—Dividends paid in securities or other property, other than its own stock, in which the earnings of a corporation have been invested, are income to the recipient to the amount of the fair market value of such property when received by the stockholders.

Scrip Dividends.—Scrip certificates issued to a corporation's stockholders, in lieu of dividends, bearing interest and redeemable within one year, are not corporate obligations similar to bonds, mortgages or deeds of trust. Payment in scrip is held to be equivalent to payment in cash, and such dividends should be included in the return of the recipient for the year in which the warrants are issued at the face value of the scrip, the transaction being regarded as a payment in cash of the dividends and an investment of the cash in scrip.

Stock Dividends.—The term "stock dividend" means a distribution by a corporation to its stockholders of the capital stock of the distributing corporation. Such a dividend is income to the amount of the earnings or profits distributed, as shown by the transfer of surplus to capital account on the books of the corporation, usually equal to the par value of the stock distributed. Stock distributions made out of surplus other than earnings or profits accumulated since February 28, 1913, when there are no such earnings or profits, are not dividends within the meaning of the statute and are free from tax. Stock dividends paid from earnings or profits accumulated after February 28, 1913, received by a fiduciary and retained as an accretion to the estate under the terms of the will or trust, are income to the estate or trust.

The question of the taxable status of stock dividends under the 1916 law is raised in the case of Macomber vs. Eisner, now pending in the Supreme Court of the United States. Inasmuch as stock dividends are expressly made subject to tax under the 1916, 1917 and 1918 laws, the language being similar in that respect, the decision will affect their taxable status under each Act.

Stock Dividends of 1918 and 1919.—By a special exception to the general rule any stock dividend received by a taxpayer between January 1 and November 1, 1918, or declared and credited to a stockholder during such period and received by him before March 27, 1919, is deemed to have been paid from the most recently accumulated earnings or profits and taxed to the recipient at the rates prescribed for the years in which the corporation accumulated

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the earnings or profits so distributed. Thus, such a stock dividend will be deemed to have been paid from the earnings of 1918 (unless paid during the first sixty days of 1918, in which case it will be deemed to have been paid from earnings accumulated during preceding taxable years), and the recipient, if an individual, will be liable to any surtax at the rates for the year 1918, unless at the time such dividend was paid or credited the current earnings up to that time were not sufficient to cover the distribution, in which case the excess over the earnings of the taxable year will be deemed to have been paid from the most recently accumulated surplus of prior years and will be taxed at the rate or rates for the year or years in which earned. A distribution made after the first sixty days of a taxable year is deemed to have been made from earnings accumulated between the close of the preceding year and the date of distribution to the extent of such earnings. A corporation declaring and paying such a stock dividend out of earnings accumulated over a period of years should make a record in its books of the amount of the dividend paid out of each year's undistributed profits and advise the stockholders accordingly.

Sale of Stock Received as Dividend.—As stock dividends were taxable income under the Revenue Act of 1916*, as well as under the present statute, but were not under the Act of October 3, 1913, different considerations may apply to the sale of stock received as a dividend before 1916 and stock so received thereafter. For the purpose of ascertaining the gain or loss derived from the sale of stock of a corporation received as a dividend, or from the sale of the stock in respect of which such dividend was paid, the cost, or if acquired before March 1, 1913, the fair market price or value as of that date of such stock, is to be determined in accordance with the following rules:

(1) In the case of stock (a) received as a dividend in 1913, 1914 or 1915 out of surplus however created, or (b) received as a dividend in 1916 or subsequent years out of surplus other than earnings or profits accumulated since February 28, 1913, the cost of each share of new stock is the quotient of the cost of the old stock divided by the number of old and new shares added together.

(2) In the case of the stock in respect of which any stock dividend was paid as described under (1), the cost of each share of old stock is similarly the quotient of the cost of the old stock divided by the number of old and new shares.

(3) In the case of stock received as a dividend in 1916 or subsequent years out of earnings or profits accumulated since February 28,

*See page 60.

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1913, the cost of each share of new stock is the quotient of the sum of (a) the cost of the old stock plus (b) the valuation at which the new stock was returnable as income (as shown by the transfer of surplus to capital account on the books of the corporation, usually its par value), divided by the number of old and new shares added together.

(4) In the case of the stock in respect of which any stock dividend was paid as described under (3), the cost of each share of old stock is similarly the quotient of the sum of (a) the cost of the old stock plus (b) the valuation at which the new stock was returnable as income, divided by the number of old and new shares.

Stock dividends declared from surplus created by the revaluation of capital assets or by placing a value on trademarks, good will, etc., do not represent a distribution of earnings or profits subject to tax as a dividend in the hands of the stockholder receiving the same. When stock received in payment of such a dividend, or stock in respect of which any such dividend was paid is sold, the cost of each share of stock whether old or new, for the purpose of ascertaining the gain or loss resulting from its sale, is the quotient of the cost of the old stock, if acquired on or after March 1, 1913, or its fair market value as of that date if acquired prior thereto, divided by the number of old and new shares added together. The profit so ascertained from a sale is income subject to both normal tax and surtax and must be returned as such for the year in which the sale is made.

Miscellaneous Income

Income from miscellaneous sources includes all those items of income which cannot conveniently be grouped under any other one head. All such income must be included in the taxpayer's return for the year in which received.

Interest in Partnership or Personal Service Corporation.—The net distributive share of a taxpayer in the earnings of a partnership of which he is a member, or of a personal service corporation in which he is a stockholder, whether such earnings are distributed or not, must be reported by such partner or stockholder as income and will be subject to tax in his hands. The proportionate share of each stockholder or partner in dividends, interest on obligations of the United States subject to tax, and taxable interest on War Finance Corporation bonds received by the partnership or personal service corporation must be included in the individual returns of the partners or stockholders for purposes of the surtax. Earnings of a personal service corporation

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accumulated prior to January 1, 1918, are not treated in the manner above described, but when distributed are regarded as corporate dividends, and as such are subject only to the surtax.

Recovery of Bad Debts.—Bad debts or accounts claimed and allowed as deductions in prior returns are considered income if subsequently collected, and should be included as such in the return of the taxpayer for the year during which recovery is had. Neither the date at which the bad debt was charged off nor the fact that it was or was not deducted from gross income in any return will affect its character as income for the year in which recovery is had.

Forgiveness of Indebtedness.—The cancellation of indebtedness is dependent upon the circumstances for its effect. It may amount to a payment of income, or to a gift, or to a capital transaction. If, for example, an individual performs services for a creditor, who, in consideration for such services, cancels the debt, income to that amount is realized by the debtor as compensation for his services. If, on the other hand, a creditor, merely desiring to benefit a debtor and without any consideration therefor, cancels the debt, the amount thereof is a gift and need not be included by the debtor in his return. If a stockholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation. If a corporation to which a stockholder is indebted forgives his debt, the transaction has the effect the of payment of a dividend.

Contributions by Stockholders.—Where a corporation needs additional funds for the conduct of its business and obtains such needed money through voluntary pro rata payments by its stockholders, the amounts thus received being credited to its surplus account, or to a special capital account, such amounts will not be considered income even though there is no increase in the outstanding shares of the corporation's stock. Such payments are regarded as in the nature of voluntary assessments upon and as representing an additional price paid for their shares of stock by the individual stockholders and will be treated as an addition to and as part of the operating capital of the corporation.

Compensation for Loss.—In the case of property lost or destroyed in whole or in part, through fire, storm, shipwreck, or other casualty, or where the owner of property has lost or transferred title by reason of the exercise of the power of requisition or eminent domain, including cases in which a voluntary transfer

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or conveyance is induced by reason of the fact that a technical requisition and condemnation proceeding is imminent, the amount received by the owner as compensation for the property may show an excess over the value of such property on March 1, 1913, or over its cost if acquired after that date, (after making proper provision for depreciation to the date of the loss, damage, or transfer). The transaction is not regarded as completed at this stage if the taxpayer proceeds immediately in good faith to replace the property, or if he makes application to establish a replacement fund. In such a case, the gain, if any, is measured by the excess of the amount received over the amount actually and reasonably expended in replacing or restoring the property substantially in kind, exclusive of expenditures for additions or betterments. The new or restored property effects a replacement in kind only to the extent that it serves the same purpose as the property which it replaces without added capacity or other elements of additional value.

The new or restored property must not be valued in the taxpayer's accounts at an amount exceeding the cost or the value as of March 1, 1913, if acquired prior thereto (after making proper provision for depreciation to the date of the loss, damage, or transfer) of the original property, plus the cost of any actual additions and betterments. If the taxpayer does not elect to replace or restore the property, the transaction will then be deemed completed, the income being measured by the excess of the amount of the compensation received over the cost of the property or its actual value on March 1, 1913, if acquired prior thereto (after making proper provision for depreciation to the date of the loss, damage, or transfer). These provisions have no application to property which is voluntarily sold or disposed of.

Replacement Fund for Loss.—Where a taxpayer elects to replace or restore the lost, damaged, or transferred property, but where it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which the entire amount of the compensation so received shall be held without deduction for the payment of any mortgage, and pending the disposition thereof, the accounting for gain or loss thereupon may be deferred for a reasonable period of time. The allowance of a replacement fund for loss, as stated in the preceeding paragraph, does not apply to property voluntarily sold or disposed of. In such a case the taxpayer should apply to the Commissioner on

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Form 1114 for permission to establish a replacement fund, reciting in the application all facts relating to the transaction and undertaking that he will proceed as expeditiously as possible to replace or restore such property.

A bond must be furnished with such surety as the Commissioner may require for an amount not less than the estimated additional income and war profits and excess profits taxes assessable upon the income so carried to the replacement fund. The estimated additional taxes for the amount of which the claimant is required to furnish security should be computed at the rates at which the claimant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters and disputes affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate so that the Commissioner, the applicant, and the surety or depositary may each have a copy.

Annuities.—All income from annuities is subject to tax, even though paid by religious, charitable, educational, or other exempt corporations, to the extent that the aggregate amount of the payments to the annuitant exceeds any amounts paid by him as consideration for the contract. An annuity charged upon devised land is taxable income to the annuitant, whether paid by the devisee out of the rents of the land or from other sources. The devisee is not required to return as taxable income the amount of rent paid to the annuitant nor is he entitled to deduct from his taxable income any sums paid to the annuitant.

EXEMPT INCOME

There are certain items of income which are expressly excluded from the gross income of a taxpayer, and which are exempt from tax whether the recipient is a citizen or resident of the United States or a nonresident alien with respect to the United States. Such income need not be included in the taxpayer's return unless information regarding it is called for, as in the case of interest on municipal bonds, interest on Federal Farm Loan bonds, etc.

Proceeds of Insurance and Damages for Injury.—Upon the death of an insured, the proceeds of his life insurance policies, whether paid to his estate or to individual beneficiaries, directly, or in trust, are excluded from the gross income of the

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beneficiary. During his life, only so much of the amount received by an insured under life, endowment or annuity contracts as represent a return, without interest, of premiums paid by him therefor, is excluded from his gross income. Whether he is alive or dead, the amounts received by an insured or his estate or other beneficiaries through accident or health insurance or under workmen's compensation acts as compensation for personal injuries or sickness are excluded from the gross income of the insured, his estate, and other beneficiaries. Any damages recovered by suit or agreement on account of such injuries or sickness are similarly excluded from gross income of the individual injured, if living, or of his estate or other beneficiaries entitled to receive such damages, if dead. Since June 25, 1918, no assessment of any Federal tax may be made on any allotments, family allowances, compensation, or death or disability insurance paid under the War Risk Insurance Act of September 2, 1917, as amended, even though the benefit accrued before that date.

Gifts and Bequests.— Money and real or personal property, received as gifts or received under a will or under statutes of descent and distribution, are exempt from tax, but the income therefrom derived from investment, sale, or otherwise, is taxable. An amount of principal paid under a marriage settlement is a gift. Alimony or allowances based on a separation agreement do not represent taxable income.

Interest upon State and Other Obligations.—Interest upon the obligations of a state, territory or any political subdivision thereof, or the District of Columbia, is exempt from tax. Obligations issued for a public purpose by or on behalf of a state or territory or a duly organized political subdivision, acting by constituted authorities duly empowered to issue such obligations are the obligations of a state or territory or a political subdivision thereof. The term "political subdivision" means any division of the state or territory made by the proper authorities acting within their constitutional powers for the purpose of carrying out a portion of those functions of the state or territory which by long usage and inherent necessities of government have always been regarded as public. The term includes special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts or divisions of a state or territory. The purchase by a state of property subject to a mortgage executed to secure an issue

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of bonds does not render the bonds obligations of the state so as to exempt the interest therefrom, whether or not the state assumes the payment of the bonds.

Dividends Paid by a Federal Reserve Bank.—The income derived from dividends on the stock of Federal reserve banks in the hands of the stockholders is exempt from income tax, but dividends paid by member banks are not exempt. The dividends on stock of Federal land banks and national farm loan associations and interest on farm loan bonds is exempt from tax.

Interest upon United States Obligations.—Although interest upon obligations of the United States is in general exempt from tax, in the case of obligations issued after September 1, 1917, including Treasury certificates of indebtedness, war savings certificates and the various Liberty bond issues (except the first Liberty Loan 3½% bonds and the 3¾% Victory notes) the interest is exempt from tax only if and to the extent provided in the acts authorizing the issue thereof, as amended and supplemented. Interest on all obligations of the United States issued after September 1, 1917, is exempt from the normal tax and the corporation income tax, but is subject to the surtax and to the war profits and excess profits taxes, except as otherwise provided in the various acts authorizing the issue of such obligations. Interest from the following maximum amounts of principal is exempt from all income and war profits and excess profits taxes. Income in excess of the maximum exemption is subject to surtax, and war profits and excess profits taxes. Form 1125 should be secured and taxable interest computed if United States obligations issued after September 1, 1917, are held in excess of the exemptions specified below.

Exempt for Life of Bonds.

3½% }
3¾% } ..... Holdings unlimited

4 % }
4¼% } ..... Aggregate Holdings of $5,000

Exempt for Five Years After Declaration of Peace.

4 % }
4¼% } ..... Aggregate Holdings $30,000[1]

(1) Additional granted by act March 3, 1919, irrespective of subscription to Victory Loan.

Exempt for Two Years After Declaration of Peace.

1st 4¼%, issue of Oct. 24, 1918, only $30,000
4th 4¼% $30,000

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Conditional Exemptions.

4 %
2nd 4¼%
3rd 4¼% } ..... Aggregate Holdings of $45,000[2]

4 %
4¼% } ..... Additional $20,000[3]

(2) For 2 years after declaration of peace, provided original subscription was made to $30,000 Fourth Loan and still owned at the date of the taxpayer's income tax return. If less than this amount, then the exemption is equivalent to 1½ times the amount so subscribed and held.

(3) Provided original subscription is made for $6,700 Victory Liberty Loan of 1923 and the notes are still owned at the date of the taxpayer's income tax return. If less than this amount is subscribed for, then the exemption is equivalent to three times the amount so subscribed and held.

Total possible exemptions on all loans $160,000.

All interest on 4¼% Victory Notes is subject to surtax and war profits and excess profits taxes.

Exemption of Liberty Bonds in the Case of Trusts.—When income is taxable to beneficiaries, as where the income of a trust is to be distributed to the beneficiaries periodically, each beneficiary is regarded as the owner of a proportionate part of the bonds held in trust and is entitled to exemption on account of such ownership as if he owned a proportionate part of the bonds directly. In such case a subscription by a trustee for bonds of the Fourth Liberty Loan or the Victory Loan, for example, constitutes each beneficiary existing at the time of such subscription an original subscriber for his proportionate part of such bonds or notes as the case may be, and entitles him to the appropriate collateral exemption of interest on bonds of previous issues, whether owned by the beneficiary or by the trustee, as though the beneficiary had himself originally subscribed for such proportionate part of the bonds or notes. A subscription of such beneficiary for bonds of the Fourth Loan or notes of the Victory Loan, as the case may be, entitles him to the appropriate collateral exemption of interest on bonds of previous issues held by the trustee.

When, however, income is taxable to the trustee, as in the case of a trust, the income of which is accumulated for the benefit of unborn or unascertained persons, the trustee is regarded as the owner of all the bonds held in trust and is entitled to exemption on account of such ownership. In such a case a subscription by the trustee constitutes the trustee as such an original subscriber and entitles him to the collateral exemption on interest on bonds of previous issues.

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Exemption in the Case of Partnerships and Personal Service Corporations. — Since the income of a partnership is taxable to the individual partners, each partner is treated as the owner of a proportionate part of the bonds held by the partnership and is entitled to exemption on account of such ownership, as if such partner owned such proportionate part of the bonds directly. Such partner, if a partner at the time of the original subscription by the partnership for bonds of the Fourth Liberty Loan, or notes of the Victory Loan, as the case may be, is treated as an original subscriber for his proportionate part of such bonds or notes subscribed for by the partnership and is entitled to the appropriate collateral exemption of interest on bonds of previous issues on account of such original subscription for bonds or notes as if he had subscribed directly for such proportionate part. The same principle applies to stockholders in personal service corporations.

Income of Foreign Governments and Their Officers.—Income of foreign governments received from sources within the United States is exempt from tax, the exemption applying to political subdivisions of foreign governments. Any income collected by a foreign government from investments in the United States in stocks, bonds or other domestic securities which are not actually owned by, but are loaned to such foreign governments is subject to tax. Income of foreign ambassadors and ministers from investments in bonds and stocks and from interest on bank balances, and the fees of foreign consuls are exempt from tax, but income of such foreign officials from any business carried on by them in the United States is taxable. The compensation of citizens of the United States who are officers or employees of a foreign government is not exempt from tax.

Income of States.—Income accruing to any state, territory, or possession of the United States, or to any political subdivision thereof, or to the District of Columbia, is exempt from tax. The income of state workmen's compensation insurance funds established by state statutes is not taxable. In the case of a public utility, acquired, constructed, operated, or maintained by a taxpayer under contract with any state, territory, or political subdivision thereof, or with the District of Columbia, containing an agreement that a portion of the net earnings of such public utility shall be paid to the state, territory, or political subdivision thereof,

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or the District of Columbia, the amount so paid may be deducted by the taxpayer as a necessary expense in transacting business.

Compensation of State Officers.—Compensation paid to officers or employees by a state or political subdivision thereof, including fees received by notaries public commissioned by states, and the commissions of receivers appointed by state courts are not taxable. Employees of universities receiving salaries paid in part or in whole from funds available under the Smith-Lever Act of May 8, 1914, who are officers or employees of a state are not required to return as taxable income the salaries so received. This is true with respect to the Act of August 30, 1890, relating to colleges for the benefit of agriculture and the mechanic arts, and the Act of March 2, 1887, relating to agricultural experiment stations in such colleges.

Compensation of Soldiers and Sailors.—A person of either sex in the active service of the military or naval forces of the United States may exclude from gross income any compensation from the United States up to the amount of $3,500 in any taxable year, but this exemption does not apply to compensation received before or after the present war, the date of the termination of the war to be fixed by the proclamation of the President. The term "military and naval forces of the United States" includes, among other things, the marine corps, the coast guard, the army nurses corps, female, and the navy nurses corps, female, and also army contract surgeons. A person is in active service if he is actually serving in such forces and is not merely on the retired or reserve list. He need not necessarily serve in the field or in the theatre of war. If such a person receives compensation from the United States of $3,500 or less and has no other income of an amount sufficient in itself to require him to render a return he need not make one. Members of draft boards are not as such entitled to this exemption.

Income Accruing Prior to March 1, 1913.—Property held by the taxpayer on March 1, 1913, represents capital. Included in such capital are claims, whether evidenced by writing or not, and all interest accrued before that date. Interest accruing on or after that date is taxable. Where an interest-bearing claim contracted before March 1, 1913, is paid in whole or in part after that date any gain derived from the conversion of the claim into money is taxable. The amount of gain is the excess of the proceeds of the claim, both principal and interest, exclusive of any interest

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accrued since February 28, 1913, already returned as income, over the fair market value of the claim as of March 1, 1913 (both principal and interest then accrued). In the case of an insurance policy, its surrender value as of March 1, 1913, may be used as a basis for the purpose of determining the gain derived from the sale or other disposition of such policy. Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued. A claim means a right existing unconditionally on March 1, 1913, and then assignable, whether presently payable or not. Interest does not, of course, include dividends on corporate stock.

DEDUCTIONS

In General

Important changes were made in the Act of 1918 in regard to deductions for both corporations and individuals, the principal of which were the addition of deductions for amortization of facilities constructed for war purposes, and for shrinkage in inventories and for rebates in 1919 made in pursuance of contracts entered into during 1918 upon sales made during such year. Other changes permit the full deduction of interest by corporations, except interest on indebtedness incurred or continued to purchase or carry tax-exempt securities; deductions by individuals of all losses in transactions entered into for profit but not connected with the trade or business; deduction for obsolescence; deduction by corporations of dividends received from corporations subject to income tax; and deduction for taxes accrued as well as paid. With certain exceptions, the deductions allowed individuals and corporations are the same.

Manner and Time of Making Deductions.—Deductions may be made either on a cash or on an accrual basis, depending upon the manner in which the taxpayer keeps his books, the accrual basis being used only when such basis is used in the determination of gross income. With the exception of the deduction of net losses, as provided under Section 204, the return of the taxpayer shall include only the deductions which pertain to the year in which the return is made. Thus, deductions of whatever character against income cannot be cumulative, but must be taken in the year in which such expenses or other allowances are paid or accrued.

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If, however, the taxpayer discovers that he has omitted a deduction in a preceding year, his return for such year may be amended, and the deduction included.

Items Not Deductible.—The following items are not allowed as deductions:

(a) Personal, living, or family expenses;

(b) Expenditures for new buildings or for permanent improvements or betterments made to increase the value of the property or estate;

(c) Expenditures for restoring property or in making good the exhaustion thereof for which allowance has been taken;

(d) Premiums on any life insurance policy covering the life of any officer or employee, or of any person financially interested in the business of the taxpayer whenever the taxpayer is directly or indirectly a beneficiary under such policy.

Personal and Family Expenses.—The following items are included in personal expenses and are not deductible:

(a) Insurance premiums paid covering a dwelling occupied by the taxpayer;

(b) Premiums paid for life insurance by the insured;

(c) The cost of equipment of an army officer, except to the extent that it is required by his profession, and does not merely take the place of articles required in civilian life;

(d) Commuter's carfare between home and office and amounts expended for luncheon.

Where a professional man uses part of his house for his office, only the portion of the rent properly attributable to his office is deductible.

Restoration of Property.—If an allowance is claimed for depreciation of property, the expense of restoring such property may not again be deducted as an item of expense or in any other manner. Repairs in the nature of replacements to the extent that they arrest deterioration and appreciably prolong the life of the property should be charged against depreciation reserve. Incidental repairs which do not add to the value of the property nor appreciably prolong its life are deductible. Small items, such as replacement of broken window panes, papering, and minor repairs, are allowable deductions, even though the full amount of depreciation has been claimed.

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Inasmuch as amounts expended for betterments are deemed to be an addition to capital, such amounts are not deductible from income. If such expenditures, however, constitute a capital investment, they may be extinguished through a proper allowance for depreciation and obsolescence.

Premiums on Life Insurance of Employees of Corporations.—The 1918 law specifically provides that a taxpayer cannot deduct premiums paid on an insurance policy on the life of an employee or individual financially interested in the taxpayer's business for the purpose of protection against loss in the event of the death of such person. The proceeds of such insurance paid upon the death of the insured to a corporate beneficiary, less any amounts paid as premiums, must be included in gross income.

Expenses in Trade or Business

Deductions are permitted of all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

Business Expenses.—Business expenses, whether subtracted from total receipts in computing gross income or deducted from gross income in computing net income, include all items entering into what is ordinarily known as the cost of goods sold, together with selling and management expenses, except such classes of deductions as are segregated under heads other than business expenses. Among the items to be treated as business expenses are material, labor, supplies, and repairs in the case of a manufacturer, while a merchant would include his purchases of goods bought for resale. In either case, the amount to be taken as a deduction in any year should be determined by taking into consideration the inventory at the beginning and end of the year. Other items that may be included as business expenses are reasonable compensation for the services of officers and employees, advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident and other similar losses in the case of a business, and rental for the use of business property. A taxpayer is entitled

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to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source derived.

A manufacturing corporation may include as an element of the cost of manufactured products, the cost of raw material, the cost of labor of the men who actually work on such products, as well as the cost of supervisory, or what may be denominated as "unproductive" labor, such as that of foremen, inspectors, overseers, etc., provided such expenditures are not separately deducted from gross income in the return of annual net income.

Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only to the extent that they are actually consumed and used in operation during the year for which the return is made, provided that the cost of such material and supplies has not been taken into account in determining the net income for any previous year. If a taxpayer carries materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible for the taxpayer to include in his expenses and deduct from gross income the total cost of such supplies and materials as were purchased during the year for which the return is made, provided the net income is clearly reflected by this method. Expenditures which are taken into account in determining the cost of products, finished or unfinished, are not to be again deducted as expenses of operation and maintenance.

Capital Expenditures.—Confusion often arises in regard to the status of certain capital charges which cannot be deducted as expenses. Thus, organization expenses of a corporation, including fees of attorneys and accountants and those paid to the state for the charter, are considered capital investments, and are not deductible. Other capital expenditures not deductible include amounts paid which add to the cost of an investment; commissions paid in purchasing and selling securities; assessments made under mutual agreement between bondholders and stockholders to be used in the reorganization of a corporation or otherwise made by a corporation upon its stockholders; expenditures for improvements and betterments; amounts paid for securing copyrights and plates which remain in the possession of and as property of the person making the payments; cost of defending title or protecting title to property; sums expended for architects' services in construction of plants or buildings.

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Professional Expenses.—A professional man may claim as deductions, the cost of supplies used by him in his profession and all expenses incidental to his work, including rent, fuel, light, telephone, etc., but cannot deduct amounts paid for books, furniture and professional instruments and equipment of a permanent character.

Depositors' Guaranty Fund.—Banking corporations, which, pursuant to the laws of the state in which they are doing business, are required to set aside a fund, generally known as a depositors' guaranty fund, may deduct the amount so set aside, if the amount ceases to be an asset of the bank and may be withdrawn by a state officer for the purpose of reimbursing depositors in insolvent banks, and if no portion of the amount credited is returnable to the banking corporation.

Compensation for Services.—Compensation for personal services, deductible as an expense of the business, must represent reasonable compensation for the purchase of services. Payments nominally made as compensation for services, which in fact include amounts paid as dividends, and payments for property or for anything other than services, are deductible only to the extent that they are not in excess of compensation paid for like services in similar enterprises.

Pensions to retired employees, or to their families, or others dependent upon them, or on account of injuries received by employees and lump sum amounts paid as compensation for injuries are proper deductions as necessary expenses, but only to the extent that they are not compensated for by insurance or otherwise. If the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs, in recognition of the services rendered by the individual, such payments may be deducted.*

Salaries paid by employers during the war to employees who are absent in the military or naval service, or who are serving the Government in other ways, at a nominal compensation, are allowable deductions.

Bonuses.—Gifts or bonuses to employees constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for services actually rendered by the employees, provided that such payments, when

*See page 45.

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added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. Donations made to employees which do not have in them an element of compensation for services are considered gratuities and are not deductible from gross income. This rule applies whether the bonus is a fixed sum or whether paid on a profit-sharing basis, the only condition being that the amount paid the employee is for services rendered and is reasonable.

Allowances to Minor Child.—As a rule, allowances given to a minor child by the parent, whether said to be in consideration of services or otherwise, are not allowable deductions in the return of income, nor are they income to the children. If however, a child has obtained his or her majority, the amount of compensation paid for service may be claimed as a deduction.

Commissions Paid to Salesmen and Agents.—Commissions paid to salesmen as part of the expense of conducting the business, are allowable deductions, whether paid in cash, stock, or other property. Likewise, commissions paid to real estate agents for collecting rents, and managing property, are legitimate business expenses and may be deducted.

Amounts paid out for expenses necessary and incidental to service rendered in earning a salary are deductible. For instance, if an agent receives a salary of $5,000 a year, but in order to transact business, he is required to rent an office and pay clerk hire amounting to $1,000 a year, he would be allowed to deduct as a business expense, the $1,000 paid out. Likewise, if he is required to furnish bond and pay a premium on such bond as a necessary incident of his employment, the premium of the bond would constitute an allowable deduction.

Traveling Expenses.—The Department has held that if an individual is required to travel in connection with his business, the railroad fares are business expenses, but meals and lodging are living expenses and not deductible. If, however, such an individual receives a salary and is also repaid his actual traveling expenses, no part of such traveling expenses repaid should be included in gross income, and therefore no deduction should be made on account of such expenses. If he receives a salary with an allowance for meals and lodging, any excess of the cost of such meals and lodging, over the allowance is not deductible, but any excess of the allowance over the actual expense is taxable income.

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Spending Money.—Spending money actually advanced by employers to traveling salesmen or others to be used by them as part of the expense incident to the transaction of business, is an allowable deduction if shown to be an ordinary and usual expense incurred in such business.

Redemption of Trading Stamps.—If a taxpayer issues with sales trading stamps or premium coupons, redeemable in merchandise or cash, he should, in computing net income from such sales, subtract only the amount received or receivable, based on the experience of the taxpayer or other users engaged in similar business, which will be required for the redemption of such part of the total issue of trading stamps or premium coupons issued during the taxable year as will eventually be presented for redemption. The taxpayer shall file for each of the five preceding years or such number of these years as stamps or coupons have been issued by him, a statement showing (a) the total issue of stamps during each year, (b) the total stamps redeemed in each year, and (c) the percentage in each year of the stamps redeemed to the stamps issued in such year. The Commissioner will examine the basis used in each return and in any case in which the amount subtracted in respect of such stamps or coupons is found to be excessive, an amended return will be required.

Expenses of Rented Property.—Expenses of rented property, including amounts paid for repairs, insurance, fuel, light and water, janitor and elevator service, and an amount representing a reasonable allowance for wear and tear and obsolescence of the property arising from its use for rental purposes, may be deducted. Insurance premiums paid in advance on rented property, covering a period of several years may be deducted in full at the time of payment if the taxpayer's books are kept on a cash basis. If the taxpayer's books are kept on an accrual basis, the premium should be prorated over the period covered by the insurance. Funds set aside by a corporation for insuring its own property are not deductible, but any loss actually sustained and charged to such funds may be deducted when the loss is sustained.

Interest

The law permits the deduction of all interest paid or accrued within the taxable year on indebtedness, or in case of a nonresident alien or foreign corporation, the proportion of such interest paid or accrued which the amount of gross income from sources within the

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United States bears to the amount of gross income from all sources within and without the United States; but interest on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917), the interest upon which is wholly exempt from income tax, is not deductible.

The use of the word "accrued" in the 1919 law should not be construed to mean that accrued interest is deductible in all cases, deduction on an accrual basis being dependent upon the taxpayer keeping his accounts on an accrual basis which clearly reflects his income. In other words, only interest actually paid is deductible, unless the requirements of the law for making return on an accrual basis are complied with.

Interest paid on bank deposits, and interest paid on indebtedness incurred or continued to purchase or to carry a dividend-paying stock, is deductible. So-called interest on preferred stock, however, which is in reality a dividend cannot be deducted. Interest on capital invested in the business but which does not represent a payment on interest-bearing obligations is not an allowable deduction from gross income.

Taxes

Deductions may be made for taxes paid or accrued within the taxable year imposed as follows:

(a) By the authority of the United States, except income, war profits and excess profits taxes;
(b) By authority of any of its possessions, except income, war profits and excess profits taxes paid during the taxable year which are allowed as credits against the tax;
(c) By authority of any state or territory or any subdivision thereof, exclusive of those assessed against local benefits;
(d) In the case of a citizen or resident of the United States, by authority of any foreign country, except the amount of income, war profits and excess profits taxes paid to such foreign country which is allowed as a credit against the tax;
(e) In the case of a nonresident alien, by authority of a foreign country, upon property or business (except income, war profits and excess profits taxes and taxes assessed against local benefits.)

Deductions for taxes are not limited to taxes paid in connection with the taxpayer's business, but are properly deductible when paid under the circumstances above indicated. As in the case of other deductions, taxes accrued may be deducted if the books of the taxpayer are kept on an accrual basis.

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State and Federal inheritance taxes are not deductible in computing the net income of an estate even though the will provides that such taxes shall be paid out of the residue.

Taxes Paid for Shareholders.—Banks or other corporations that pay taxes assessed against their stockholders on account of their ownership of the shares of stock issued by such banks or corporations cannot deduct the amount of taxes so paid. The shares of stock are the property of the stockholders and to the extent that the taxes assessed on the value of the shares of stock are property taxes the holders of the stock are primarily liable for their payment. Such payments are therefore regarded as in the nature of additional dividends, and must be included by the stockholder as income, but may be deducted by him as taxes paid. By including the amount paid as a dividend and taking a deduction for the same as a tax, the stockholder does not change the amount of his surtax, but reduces the normal tax by an amount equal to the normal tax on the amount of the dividends so added. If stock is sold and transferred between the date of assessment and payment of the tax, in the absence of a statute providing otherwise, the stockholder liable for the tax would have the benefit of the tax deduction in the return of income.

Taxes for Local Benefits.— Assessments paid for local benefits, such as street, sidewalk, and other like improvements, imposed because of and measured by some benefit inuring directly to the property, against which the assessment is levied, do not constitute allowable deductions from gross income. Taxes are considered assessed against local benefits when the property subject to the tax is limited to the property benefited, but such special assessments are not deductible even though an incidental benefit may inure to the public welfare.

If assessments are made for the purpose of maintenance or repair of local benefits, the taxpayer may deduct the assessments paid as an expense incurred in business if the payment of such assessments is necessary to the conduct of the business. Where the assessments are made for the purpose of constructing local benefits, the payments by the taxpayer are in the nature of capital expenditures and not deductible.

Federal Duties and Excise Taxes.—Import or tariff duties, business, license, privilege, excise, and stamp taxes are deductible as taxes imposed by the authority of the United States,

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provided they are not added to and made part of the expense of the business, or to the cost of articles or merchandise with respect to which they are paid.

Taxes Paid in Behalf of Another.—Taxes paid in behalf of a taxpayer by a debtor on interest or other income paid by such debtor may be deducted as a business expense, except that tax paid to the Federal Government under a "tax-free" covenant contained in a corporate bond may not be deducted. Where, however, tax is paid to a state in pursuance of such a covenant it is deductible as interest paid on indebtedness.

Losses

The 1918 law provides that in computing net income, losses shall be deductible as follows:

Individuals—(a) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(b) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

(c) Losses sustained during the taxable year of property not connected with the trade or business, if arising from fires, storms, shipwreck or other casualty, or from theft, if not compensated for by insurance or otherwise;

Corporations—Losses sustained during the taxable year and not compensated for by insurance or otherwise.

It is not necessary that losses be charged off within the taxable year, it being sufficient that they are charged off before they are allowed as deductions. Accordingly, at the time of examination of a corporation's return, a corporation is allowed to reopen its books and charge off losses actually sustained during the prior taxable year.

Individual Losses Not Connected with Trade or Business.—Under the 1918 law an individual is permitted to deduct in full losses incurred in transactions entered into for profit but not connected with his trade or business. The allowance of this deduction does not contemplate the deduction of losses in connection with transactions purely personal in character which are not entered into directly for profit. Thus, a loss on the sale of a house purchased and occupied by the taxpayer for his residence, or upon an automobile purchased exclusively for pleasure is not deductible.

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Losses Through Fire, Flood or Other Casualty.—The amount of deductible loss in the case of destruction of property by fire, flood, or other casualty is the difference between the cost of the property or its fair market value as of March 1, 1913, and the salvage value after deducting from the cost or value as of March 1, 1913, the amount, if any, which should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. The loss should also be reduced by the amount of any insurance or other compensation received. The loss must be definitely ascertained, and if a claim is pending for settlement or insurance, no part of the loss which might have been compensated for through a settlement in favor of the taxpayer is deductible until the claim is adjusted.

Losses Must Be Actual.—Losses sustained from the sale or other dealings in property, of whatever kind, growing out of the ownership of or interest in such property, in order to be deductible, must not be speculative or fluctuating valuations of continuing investment, but must represent absolute losses actually sustained and ascertained during the taxable year for which the deduction is sought. Such a loss must be determined as a result of an actual completed and closed transaction. Book values merely reflecting a shrinkage in the value of securities are not a proper basis for determining gain or loss, even though such securities are written off at the direction of the Comptroller of the Currency, or a state bank official.

Mere book entries do not constitute a loss for the purpose of this deduction. Losses of the character contemplated by the law are only ascertainable in the case of securities, when such securities mature or are disposed of or cancelled, an exception being made, of course, in the case of dealers in securities and in merchandise.

If stock of a corporation becomes worthless, its cost or the fair market value as of March 1, 1913, if acquired prior to that date, may be deducted by the owner for the year in which the stock was ascertained to be worthless and charged off, but a satisfactory showing of its worthlessness must be made, as in the case of bad debts.

Termination of Usefulness of Property.—If, through some change in business conditions, the usefulness in the business of any of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which

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he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation allowance) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where machinery or other property must be replaced by a new invention, or where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. The exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized, nor does it apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. The loss here referred to should not be confused with the deduction for amortization.*

Old Buildings Razed for Construction of New.—When a taxpayer buys real estate upon which is located a building which he razes with a view to erecting another building in its place, no deductible loss is sustained by reason of the demolition of the old building, nor will there be any deductible expense on account of the cost of removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and buildings, plus the cost of removing the useless building.

Voluntary Removal of Buildings.—Loss due to voluntary removal or demolition of old buildings, and the scrapping of old machinery and equipment incident to renewals and replacements, is deductible from gross income in a sum representing the difference between the cost of the demolished or scrapped property and the amount of reasonable allowance for depreciation which it had undergone prior to its demolition or scrapping. The deductible loss is only so much of the original cost of the property, less salvage, as

*See page 87.

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would have remained unextinguished had a reasonable allowance been charged off for depreciation during each year prior to destruction.

Bad Debts

Bad debts ascertained to be worthless and charged off within the taxable year may be deducted, whether or not such debts were incurred in the business or trade. An account merely written down, however, or recognized as worthless prior to the beginning of the taxable year is not deductible. Only those losses on account of bad debts which have been definitely ascertained to have occurred during the taxable year are deductible, and the taxpayer must be able to show not only that the debt was worthless, but that it was definitely determined to be worthless at the time charged off, and was not recognized as worthless prior to the beginning of the year for which return was made.

Debts Arising from Capital.—All debts representing amounts that became due and payable prior to March 1, 1913, and not ascertained to be worthless prior to that date, whether representing income or a return of capital, are allowable deductions for the year in which they are ascertained to be worthless and charged off. The value used in computing such losses shall be the fair market value of the debt as of that date. Debts arising on and after March 1, 1913, on account of items of income are not proper deductions, unless such amounts have been included as income in the year in which earned or accrued.

Determination of Worthlessness.—Where all of the surrounding and attending circumstances indicate that a debt is worthless and not collectible, and that legal action to enforce payment would not result in the satisfaction of execution on a judgment, a showing of these facts would be sufficient evidence of the worthlessness of the debt for the purpose of the deduction. For example, the report of a mercantile agency of the financial condition of the debtor should be sufficient evidence to establish the status of the debt.

Bankruptcy may or may not be an indication of the worthlessness of a debt, and the actual determination of worthlessness in such a case is sometimes possible before or at other times only after a settlement in bankruptcy shall have been had. In cases in which bankruptcy proceedings are instituted, and the report of the receiver shows a definite loss, the taxpayer should be permitted to

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take the loss so determined in the year in which the receiver's report is issued. Where the taxpayer has ascertained a debt to be worthless and charged it off in one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, confirming the conclusion that the debt is worthless, will not authorize shifting the deduction to such later year. In any case, only the difference between the amount received in distribution of the assets of the bankrupt and the amount of the claim may be deducted as a bad debt. A debt voluntarily forgiven without adequate steps being taken to recover from the debtor, does not constitute a bad debt.

The difference between the amount received by a creditor of a decedent, in distribution of the assets of the decedent's estate and the amount of his claim may be considered a worthless debt. The purchaser of accounts receivable which cannot be collected and which are consequently charged off the books as bad debts, is entitled to deduct the value of such accounts, the amount of the deduction being based upon the price paid for them, if acquired subsequent to March 1, 1913, and not upon their face value. If a taxpayer computes his income upon the basis of valuing his notes or accounts receivable at their fair market value when received, the amount deductible for bad debts in any case is limited to such original valuation.

Mortgage Debt.—If a mortgagee buys in the mortgaged property and credits the indebtedness with the purchase price, the difference between the purchase price and the indebtedness is not an allowable deduction, but the determination of the loss is deferred until the property is disposed of. This rule does not apply where a purchase money mortgage is foreclosed by the vendor of the property. For deferred payment sales, see page 52.

Worthless Bonds.—Bonds ascertained to be worthless may be deducted as bad debts in the year in which ascertained to be worthless and charged off. If purchased prior to March 1, 1913 the amount deductible is the fair market value as of that date. If purchased on or after March 1, 1913, the cost of the bond is the amount deductible, but it may not exceed the amortized value, if purchased at a premium.

Depreciation and Obsolescence

Individuals and corporations may deduct a reasonable allowance for exhaustion, wear and tear of property used in the trade or busi-

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ness, including a reasonable allowance for obsolescence. For convenience, this allowance is usually referred to as covering depreciation, excluding from the term any idea of mere reduction in the market value not resulting from exhaustion, wear and tear or obsolescence. Obsolescence was not mentioned in the law prior to 1918. The allowance for depreciation of property used in the trade or business is that amount which should be set aside for the taxable year in accordance with the consistent plan by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value at the end of such useful life, to provide in place of such property its cost or its fair market value as of March 1, 1913, if acquired by the taxpayer prior to that date.

In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art or to becoming inadequate to the growing needs of the business. It does not apply to inventories or to stock in trade; nor to land, apart from improvements or physical developments added to it. The fact that deductions are made for ordinary and necessary repairs to the property does not prevent the deduction of a reasonable depreciation allowance.

The deduction for depreciation is limited to property used in the taxpayer's trade or business. Therefore, no depreciation may be taken on a taxpayer's residence, automobiles or other vehicles used for pleasure, or on furniture, clothing, or personal effects not used in the taxpayer's business.

Inasmuch as the depreciation allowance in prior years did not include obsolescence, the taxpayer, for the year 1918 and subsequent years, should revise the estimate of the useful life of any depreciable property so as to allow for such future obsolescence as may be expected from experience to result from the normal progress of the art or inadequacy of the property to the growing needs of the business. No modification of the method should be made on account of changes in market value of property from time to time, such as, on the one hand, loss in rental value of buildings due to deterioration of the neighborhood, or, on the other, appreciation due to increased demand. The conditions affecting such market values should be taken into consideration only so far as they affect the estimate of the useful life of the property.

Capital Recoverable Through Depreciation.—The capital sum to be replaced by depreciation allowances is the cost

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of the property or the fair market value of such property on March 1, 1913, if acquired prior to that date. To this sum should be added, from time to time, the cost of improvements, additions and betterments, which cost has not been deducted as an expense in the taxpayer's return. Deductions should be made, from time to time, on account of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility, which is the basis of the depreciation allowance.

Method of Computing Depreciation Allowance.—The capital sum to be replaced should be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. No rate is fixed by which an allowable deduction on account of depreciation in value of any class of property subject to wear and tear is to be computed. The Department, in former years, without prescribing any definite rates, has estimated that the average useful life of a frame building is twenty-five years, a brick building thirty-five years, and a stone building, or steel and concrete building, from fifty to one hundred years, and that the average life of ordinary machinery is ten years, and of automobiles used for business or farm purposes and farm tractors, four to five years. The estimated life of the property, however, must be determined in each case by the character of the property and the use to which it is put.

Depreciation of Land and Securities.—Land is not reduced in value by reason of wear and tear and it therefore follows that no depreciation allowance may be taken in respect of the same. Likewise, no allowance may be taken to cover shrinkage in the value of stocks, bonds and like securities due to fluctuations in the market value, except in the case of dealers, who are permitted to inventory their securities.

Intangible Properties.—Intangible property, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance, for example, patents, copyrights, licenses and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the life of which can be estimated from experience with reasonable certainty, such

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intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return of the taxpayer.

In the case of a patent or copyright, the capital sum to be replaced in the cost of the patent (not already deducted as current expense), or its fair market value as of March 1, 1913, if acquired prior thereto. The allowance should be computed by an apportionment of the cost of the patent or copyright or its fair market value as of March 1, 1913, over the life of the patent or copyright, since its grant, or since its acquisition by the taxpayer, or since March 1, 1913, as the case may be.

A taxpayer who has incurred expenses for designs, drawings, patents, models, or work of an experimental nature calculated to result in improvement of the taxpayer's facilities or product, may at his option, deduct such expenses from gross income for the taxable year in which they are incurred, or treat such property as a capital asset to the extent of the amount so expended. In the latter case, if the period of usefulness of any such asset may be estimated from experience with reasonable accuracy, it may be the subject of depreciation allowances spread over such estimated period of usefulness.

If machinery or equipment is operated more than the usual number of working hours, a higher rate of depreciation may be taken than if operated under normal conditions.

Amortization

The taxpayer may make a reasonable deduction from gross income, not in excess of a sum sufficient to extinguish the cost of buildings, machinery, equipment, or other facilities constructed, erected, installed or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war, and of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the war. The provision is broad in its terms, and does not limit the deduction to property and facilities directly used for war purposes, but includes those contributing to the prosecution of the war. In the case of property, the construction or installation of which was commenced before April 6, 1917, and completed subsequent to that date, amortization will be allowed with respect only to the cost incurred on and after April 6, 1917.

Claims.—Claims for amortization must be unmistakably differentiated in the return from all other claims for depreciation,

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obsolescence and loss. The allowance for amortization should cover the decline in value of the property subject thereto, and is inclusive of the depreciation which would ordinarily be allowable separately. Depreciation for any taxable period after December 31, 1917, should, therefore, not be claimed with respect to property as to which an allowance for amortization is claimed. The total amount to be extinguished by amortization in general is the excess of the unextinguished or unrecovered cost of the property over its maximum value, under stable postwar conditions. For the purpose of making returns for 1919, the total amount to be extinguished by amortization is the difference between the value of the property on the basis indicated in the following paragraphs, and the original cost of the property, less any amounts otherwise deducted for depreciation, losses, etc., prior to January 1, 1918; or in the case of property acquired or completed after December 31, 1917, it is the difference between the value of the property on the basis indicated below, and the cost of such property at the date of acquisition or completion:

(1) In the case of property useful only during the war period and permanently discarded at the date of the return, the basis is the salvage value as of the date when the property was discarded. In this case, for the purpose of making returns in 1919, the amount to be extinguished by amortization will be spread in proportion to the net income (computed without benefit of the amortization allowance) between January 1, 1918, and the date when the property was permanently discarded.

(2) In the case of property still in use, which will not be required for the future use of the business and which is certain to be permanently discarded before the last installment payment of the tax covered by the return, the basis is the salvage value as of the date when the property will be permanently discarded. In this case, for the purpose of making returns in 1919, the amount to be extinguished by amortization shall be spread in proportion to the net income (computed without benefit of the amortization allowance) between January 1, 1918, and the date upon which the property will be permanently discarded.

(3) In the case of other property, the basis for amortization calculation shall be the estimated value of the property to the taxpayer in terms of its actual use or employment in his going business, such value in no case to be less than the sale or salvage value of the property. In no case, however, shall the pre-

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liminary estimate (for purposes of returns to be made in 1919) of the amount of such amortization exceed 25 per centum of the cost of the property. In the final determination, the amount of the amortization allowance will be ascertained upon the basis of stable postwar conditions when these conditions become apparent. For the purpose of making returns in 1919, the amount to be extinguished by amortization shall be spread in proportion to the net income (computed without the benefit of the amortization allowance) between January 1, 1918, and April, 1919.

A special record of all property falling in classes (1) and (2) must be preserved by the taxpayer, and the Commissioner must be promptly advised (a) if such property is restored to use; (b) the selling price if sold; and (c), if still on hand and not in use at the close of the three year period, the reasons why such property has not been disposed of.

All taxpayers claiming an allowance for amortization will be required to estimate the amount of their net income for the period between January 1, 1918, and the dates specified above, and also to estimate what part of such net income is properly allocable to the calendar year 1918 and what part to the calendar year 1919. These estimates will be the basis for apportioning the amounts to be extinguished by amortization between the calendar years 1918 and 1919. Taxpayers reporting on the fiscal year basis (a) in all computations based upon 1918 rates must use the amount of such allowance apportioned to the calendar year 1918; (b) in any computation based upon 1919 rates for a year beginning in 1918 and ending in 1919, must use the amount of such allowance apportioned to the calendar year 1919; and (c) in any computation for a fiscal year beginning in 1919 must use as many twelfths of the allowance apportioned to the calendar year 1919 as there are months of such fiscal year falling in the calendar year 1919.

Evidence to Be Furnished by Taxpayer.—The regulations provide that the taxpayer must establish to the satisfaction of the Commissioner that the entire deduction claimed and the proportion claimed for any particular year are reasonable. The taxpayer must submit a statement setting forth the following information:

(a) a description of the property in reasonable detail;
(b) the date or dates on which the property was acquired, and from whom, or, if constructed, erected, or installed by the taxpayer, the dates on which such construction, erection or installation was begun and completed;

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(c) evidence establishing the intention of the taxpayer on and after April 6, 1917, or on and after the date of the acquisition or the date of beginning construction, erection, or installation to devote such property or vessels to the production of articles (or, in the case of vessels, the transportation of articles or men) contributing to the prosecution of the present war;
(d) the cost of construction, erection, installation or acquisition;
(e) the value of the property after termination of the amortization period;
(f) a segregation of the property permanently discarded, or of the property which will be permanently discarded, before the last installment payment covered by the return;
(g) all deductions from gross income otherwise taken or claimed with respect to such property;
(h) the computation by which the total amount to be extinguished by amortization was determined; and,
(i) the computation by which the proportion of the amortization charge claimed as a deduction in the taxable year for which the return is being made was determined.

Redetermination of Deduction.—A redetermination of the deduction allowed on account of amortization may, or at the request of the taxpayer shall be made by the Commissioner at any time within three years after the termination of the present war, and if as a result of an appraisal or from other evidence it is found that the deduction originally allowed was incorrect, the amount of tax due for each taxable year during the amortization period will be adjusted by additional assessment or by refund.

Depletion

The 1918 law allows a deduction of a reasonable allowance for depletion of natural deposits and for depreciation of improvements in the case of mines, oil and gas wells, other natural deposits, and timber, the deduction being taken according to the peculiar conditions of each case based upon cost, including the cost of development not otherwise deducted. In the case of such property acquired prior to March 1, 1913, the fair market value as of that date must be taken in lieu of the cost up to that date. In the case of the discovery of mines, oil and gas wells on or after March 1, 1913, not acquired as a result of the purchase of a proven tract or lease, if the fair market value is materially disproportionate to the cost, the depletion allowance will be based on the fair market value on the date of discovery or within thirty days thereafter. The allowance in the above cases is to be made under such regulations as are prescribed by the Commissioner; and in the case of leases the deduction must be apportioned between the lessor and the lessee.

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Depletion Allowance in the Case of Owner.—In the case of an operating owner in fee or a lessor, the capital remaining in any year recoverable through depletion allowances is the sum of

(a) the cost of the property, or its fair market value as of March 1, 1913, or its fair market value within 30 days after discovery, as the case may be, plus
(b) the cost of subsequent improvements and development not charged to current operating expenses, but minus
(c) deductions for depletion which have or should have been taken to date, and
(d) the portion of the capital account, if any, as to which depreciation has been and is being deducted instead of depletion.

The value of the surface of the land should be taken into consideration, but a lessor may not include in his capital recoverable through such an allowance any part of development costs not borne by the lessor, nor any part of the discovery value.

Depletion Allowance in the Case of Lessee.—In the case of a lessee the capital remaining in any year recoverable through depletion allowances is the sum of

(a) the cost of the leasehold, or its fair market value as of March 1, 1913, or its fair market value within 30 days after discovery, as the case may be, plus
(b) the cost of subsequent improvements and development not charged to current operating expenses, but minus
(c) deductions of depletion which have or should have been taken taken to date, and
(d) the portion of the capital account, if any, as to which depreciation has been and is being deducted instead of depletion.

Any annual or periodical rents or royalties supplementing the bonus or other amount paid for the lease may be charged to current operating expenses or, until the property reaches the operating stage, to capital account, and in the latter event will form part of the capital returnable through deductions for depletion.

Depletion Allowance Apportioned Between Lessor and Lessee.—As the value of property comprehends the interests of both lessor and lessee, no computation, for the purpose of depletion allowances, of the value of these interests separately as of any date which combined exceeds the value of the property in fee simple will be permitted. This principle is applicable to holders of fractional interests. If the aggregate deduction claimed is deemed excessive, the Commissioner may request the owner or lessee to show that the valuation claimed does not exceed the fair

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market value of the property at a specified date determined in accordance with prescribed regulations. The lessor and the lessee, with the approval of the Commissioner, must equitably apportion the allowance in the light of the peculiar conditions in each individual case and on the basis of their respective interests therein. Every taxpayer claiming an allowance for depletion in respect of property in which he owns a fractional interest only, or a leasehold, or property subject to a lease, must attach to his return a statement showing the name and address and the precise nature of the holdings of each person interested in the property. The regulations covering the determination of the allowance are set forth in detail in Regulations 45, Arts. 201 to 233.

Contributions

Contributions or gifts made within the taxable year by an individual are deductible to an aggregate amount not in excess of 15 per centum of the taxpayer's net income, computed without the benefit of this deduction, if made to corporations and associations organized and operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or if made to the special fund for vocational rehabilitation authorized by Section 7 of the Vocational Rehabilitation Act. There must be stated on the return the name and address of the organization to which a gift was made and the amount and approximate date of each such gift. Where the gift is other than money, as, for example, a house, the basis of calculation of the amount of the gift will be the fair market value of the property at the time given. A gift of real estate made to a city to be maintained perpetually as a public park, is not an allowable deduction under the heading of contributions.

Loss on Inventories and Rebates

At the time of filing returns for the taxable year 1918, a taxpayer was allowed to file a claim in abatement (Form 47) based on the fact that he had sustained a substantial loss, whether or not actually realized by sale or other disposition resulting from any material reduction (not due to temporary fluctuation) of the value of the inventory for such year. In such case, payment of the amount of the tax covered by such claim was not required

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until the claim was decided, but the taxpayer was compelled to accompany his claim with a bond in double the amount of the tax covered by the claim, with sureties satisfactory to the Commissioner, conditioned for the payment of any part of such tax found to be due, with interest. Similar relief was given in the case of losses resulting from the actual payment, after the close of the taxable year 1918, of rebates in pursuance of contracts entered into during such year upon sales made therein.

The taxpayer, however, in lieu of such claim for abatement, may file a claim for refund on Form 46 not later than thirty days after the close of the taxable year 1919, adjusting the entire claim for losses at the close of such year.

Determination of Losses.—Inventory losses were allowable either (a) where goods included in an inventory at the end of the taxable year 1918 were sold at a loss during the succeeding taxable year, or (b) where such goods remain unsold throughout the taxable year 1919 and at its close have a then market value (not resulting from a temporary fluctuation) materially below the value at which they were inventoried at the end of the taxable year 1918. A deduction is not permitted for loss of anticipated profits, for a loss not substantial in amount, or for physical damage or obsolescence occurring in the taxable year 1919. In determining whether goods included in the inventory at the end of the taxable year 1918 have been sold during the succeeding taxable year, and whether loss has resulted therefrom, sales of goods made in the taxable year 1919 will be deemed to have been made from the inventoried stock of 1918 until such inventoried stock is exhausted.

Should any goods unsold, upon which a claim in abatement has been filed at the time of filing return, be disposed of by sale at some future period within the taxable year 1919, the taxpayer should keep a record of the sales effected, deducting therefrom the proportionate cost of operating and selling expenses. The gain or loss would then be ascertained by computing the difference between the adjusted sales values and the inventory value established at the time of filing the claim in abatement. If, at the close of the taxable year 1919 there remains any commodity unsold, the taxpayer should adjust the inventory value to the market price, ignoring mere temporary fluctuations in price or value, at the close of the taxable year and compute the amount of gain or loss. Such gain or loss is to be combined with the gain or loss on sales between the time of filing the return and the close of the taxable year 1919.

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If it appears that the taxpayer has sustained a loss in addition to that shown in the claim in abatement, a claim for refund should be made on Form 46 for the amount of tax overpaid. Should it be shown that the amount deducted in the claim in abatement at the time of filing the return for the taxable year 1918 is in excess of the tax based upon actual losses sustained throughout the taxable year 1919, the taxpayer must remit to the collector the additional amount of tax involved with interest at the rate of one per centum per month from the time of filing the return until the date of filing the final adjustment of taxes for the taxable year 1918 on account of inventory losses.

What Claims Embrace.—Summarized statements covering all adjustments involved must be filed with the original claim and at the close of the taxable year 1919. The totals of these summaries should equal the total inventories maintained in detail by the taxpayer. Claims for losses in inventories of the taxable year 1918 embrace all items of the taxpayer's inventory, so that gains made in any sales of certain items or classes will be used to offset losses in others, and the net result as to the entire inventory determined. Therefore, if the final computation shows a net gain over all inventory items sold no claim for loss in any particular item or items can be sustained.

1919 Profits Adjusted.—If a claim for inventory loss is finally allowed, the net income for 1919, as established by the usual accounting methods, will be correspondingly higher as represented in the return for the taxable year 1919. The Department recommends that the accounting records of the taxpayer remain unchanged and that any adjustment of inventories be recorded in distinct accounts supported by adequate detailed schedules.

Loss from Rebates.—Where, after the close of the taxable year 1918, rebates have been bona fide paid, in pursuance of contracts entered into during such year, upon sales made therein, the net income for that year may be reduced by the deduction of the amount of such rebates actually paid. No deduction is permitted unless the profits from the sales have been included in the income for the taxable year 1918. A separate schedule should be submitted in such cases, showing the date of each rebate; the name and address of each party securing the benefit thereof; a description of the goods; the quantities; the sales value of each item; the amounts rebated, and the total included in the taxpayer's claim in abatement.

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Rebates made during the taxable year 1919 on sales made during such year, where the goods to which the rebate applies were included in the inventory at the close of the taxable year 1918, will be considered as an adjustment of sales values in arriving at the loss on inventories for the taxable year 1918. Such loss cannot be included in the rebate claim, but the rebate may be considered in determining the sale price for the purpose of determining an inventory loss. Rebates made on goods acquired and sold subsequent to the end of the taxable year 1918 cannot be deducted as a 1918 loss.

Net Losses

Scope of Net Losses and Claim for Allowance Therefor.—Under the law the term "net losses" means either a business operating loss or a loss realized by a bona fide sale of property constructed or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war. Any net loss claimed must represent an actual net loss over and above all income, including tax-free income. Such losses will be allowed only in respect of a taxpayer having a taxable year beginning after October 31, 1918, and ending prior to January 1, 1920. Any such claim should be filed on Form 46 with the taxpayer's return of income for the taxable year 1919, and should contain a concise statement of the loss sustained, in accordance with the return, the nature of the loss, the amount of the taxpayer's net income for the taxable year 1918, the taxes paid by him with respect thereto, and all pertinent facts necessary to enable the Commissioner to determine the allowability of the claim. After one claim has been allowed, no further claim can be considered.

Allowance of Net Loss.—Any amount allowed by the Commissioner in respect to any such claim shall be deducted from the net income for the taxable year 1918 and the income and war profits and excess profits taxes, if any, for such year shall be recomputed accordingly, and any amount found to be due the taxpayer shall be credited or refunded. In any case in which such net loss exceeds the net income of such preceding taxable year such excess may be carried forward and claimed as a deduction in computing net income for the succeeding taxable year.

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PART III. INCOME TAX—RETURNS, PAYMENTS, AND CLAIMS

RETURNS

Under the 1918 law, individuals, fiduciaries, partnerships, and corporations are required to make return on the basis of their annual accounting period, whether a calendar year or a fiscal year other than the calendar year. A taxpayer having an existing accounting period which is a fiscal year within the meaning of the statute not only needs no permission to make his return on the basis of such a taxable year, but is required to do so, regardless of the former basis of rendering returns. A taxpayer having no such fiscal year must make return on the basis of the calendar year.

Returns When Accounting Period Changed.—No return can be made for a period of more than 12 months. A separate return for a fractional part of a year is, therefore, required wherever there is a change (with the approval of the Commissioner) in the basis of computing net income from one taxable year to another taxable year, or wherever a taxpayer making his first return does so on a fiscal year basis. The requirements with respect to the filing of such a return and the payment of tax are the same as for a return for a full taxable year closing at the same time. When a return is made for a period less than a year, the tax shall be paid at the rate for the calendar year in which such period is included, and the credits for personal exemption and dependents shall be such proportion of the full credits as the number of months in such period bears to 12 months.

Individuals

Every individual whose net income is

(a) $1,000 or over, if single, or if married and not living with husband or wife, or
(b) $2,000 or over, if married and living with husband or wife,

must file a return for his taxable year, whether calendar or fiscal. Whether or not an individual is the head of a family, or has dependents, is immaterial in determining his liability to render a

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return. If an individual is a married person living with husband or wife, no return need be made where their aggregate net income is less than $2,000; but a separate return must be made by each of them, regardless of the amount of the individual income of each, where their aggregate net income is $2,000 or over, unless they join in a single return. The husband shall include in his return the income derived from services rendered by his wife or from the sale of products of her labor if she does not file a separate return or join with him in a return setting forth her income separately.

The return may be made by an agent when by reason of illness, absence, or nonresidence, the person liable for the return is unable to make it, the agent assuming the responsibility for making the return and incurring liability to the specific penalties provided for erroneous, false, or fraudulent returns.

Form of Return.—The return shall be on Form 1040, Revised, when the net income exceeds $5,000, and on short Form 1040-A, Revised, when the net income does not exceed $5,000 and the part subject to normal tax, after applying the personal exemption and other credits, does not exceed $4,000.

Return of Income of Minor.—An individual under 21 years of age or under the statutory age of majority where he lives, whatever it may be, is required to render a return of income if he has a net income of his own of $1,000 or over for the taxable year, if single, or $2,000 or over, if married, and living with husband or wife. If a minor is dependent upon his parent who appropriates his earnings, such earnings are considered income of the parent. In the absence of proof to the contrary a parent will be assumed not to have emancipated his minor child and must include in his return any earnings of the minor.

Return of Income of Nonresident Alien.—A nonresident alien individual shall make or have made a full and accurate return on Form 1040, Revised, or 1040-A, Revised of income received from sources within the United States, regardless of the amount unless the tax has been fully paid at the source. Representatives of nonresident aliens in connection with any sources of income which such nonresident aliens may have within the United States shall make a return of such income, and pay the tax due, in all cases where the tax on the income in their receipt, control, or custody has not been withheld at the source. Where upon filing a return of income it appears that a nonresident alien is not liable

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for tax, but nevertheless a tax has been withheld at the source, in order to obtain a refund, a statement should be attached to the return showing the amounts of tax withheld, with the names and addresses of all withholding agents.

Corporations

Every corporation, not exempt from tax under Section 231 of the law, must make a return of income, regardless of the amount of its net income. Such return shall be on Form 1120, for the calendar year, or Form 1120-A for a fiscal year, other than the calendar year, ending in 1919. A corporation which is in existence during any portion of a taxable year is required to make a return. but a corporation which has received a charter, but has never perfected its organization, and which has transacted no business and had no income from any source, may, upon presentation of the facts to the collector, be relieved from the necessity of making a return so long as it remains in an unorganized condition.

If the net income includes an amount in excess of $10,000 from Government contracts*, Form 1120-S must accompany the return.

Returns for Fractional Part of Year.—In the case of a corporation making its first return of income on the basis of a fiscal year and in the case of a corporation changing its accounting period, whether from calendar year to fiscal year, from fiscal year to calendar year, or from one fiscal year to another fiscal year, a separate return for a fractional part of a year is required.†

Returns of Foreign Corporations.—Every foreign corporation, not exempt under Section 231 of the law, (page 159), having income from sources within the United States, must make a return of income on Form 1120. If such a corporation has no office or place of business in the United States, but has a resident agent, he shall make the return. It is not necessary, however, that a foreign corporation shall be engaged in business or that it have any office, branch, or agency in the United States, in order that it be required to make a return.

Returns by Receivers.—Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations on Form 1120, covering each year or part of a year during which they are in control. Notwithstanding that the powers and functions of a corporation are suspended and that

* See page 116.
† See pages 32 and 112.

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the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee, stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control.

Returns in Special Cases.—Where a corporation enters on its return an excess profits tax equal to the amount of the maximum tax, determined under Section 302 of the statute, (page 174), the items on Form 1120 which relate solely to invested capital for the taxable year need not be filled in. Likewise, in the case of a foreign corporation the same items may be disregarded, except that all schedules called for on pages 1 and 4 of the return with respect to its income within the United States should be filled in, and the income tax computed without claiming any specific exemption under Item 9. The Commissioner may at any time, however, call for any information which is not required to be entered on the return. In any case where a claim is made under Sections 327 and 328 of the statute, other than in the case of a foreign corporation, the corporation should fill out all items of the return so far as possible and submit a statement explaining why it is impracticable to fill out the entire return.

Consolidated Returns.—Affiliated corporations are required to file consolidated returns on Form 1120. The consolidated return shall be filed by the parent or principal reporting corporation with the collector of the district in which it has its principal office. Each of the other affiliated corporations shall file with the collector of its district Form 1122, along with the several schedules indicated thereon.

Foreign corporations and personal service corporations need not file consolidated returns.

When Corporations Are Affiliated.—Corporations will be deemed to be affiliated

(a) when one domestic corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or,
(b) when substantially all the stock of two or more domestic corporations is owned or controlled by the same interests.

The words "substantially all the stock" cannot be interpreted as meaning any particular percentage, but must be construed according to each particular case. The owning or controlling of 95 per

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centum or more of the outstanding voting capital stock (not including the stock in the treasury) at the beginning of and during the taxable year will be deemed to constitute an affiliation within the meaning of the statute. Consolidated returns may, however, be required even though the stock ownership is less than 95 per centum. When the stock ownership is less than 95 per centum, but in excess of 50 per centum, a full disclosure of affiliations should be made, showing all pertinent facts. Such statement should preferably be made in advance of filing the return, with a request for instructions as to whether a consolidated return should be made. In any event such a statement should be filed as a part of the return. The words "the same interests" shall be deemed to mean the same individual or partnership or the same individuals or partnerships, but when the stock of two or more corporations is owned by two or more individuals or by two or more partnerships a consolidated return is not required, unless the percentage of stock held by each individual or each partnership is substantially the same in each of the affiliated corporations.

Change in Ownership During Taxable Year.—When one corporation owns substantially all the stock of another corporation at the beginning of any taxable year, but during the taxable year sells all or a majority of such stock to outside interests not affiliated with it, or when one corporation during any taxable year acquires substantially all the capital stock of another corporation with which it was not previously affiliated, a full disclosure of the circumstances of such changes in ownership shall be submitted to the Commissioner, who shall decide whether or not separate or consolidated returns shall be filed.

Corporation Deriving Chief Income from Government Contracts.—In the case of any affiliated corporation organized after August 1, 1914, and not a successor to a then existing business, 50 per centum or more of whose gross income consists of income derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, the net income and invested capital of such corporation shall be taken out of the consolidated net income and invested capital of the group of affiliated corporations and the corporation so segregated shall be separately assessed on the basis of its own invested capital and net income, the remainder of such affiliated group being assessed on the basis of the remaining consolidated invested capital and net income.

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Consolidated Net Income of Affiliated Corporations.—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions, the consolidated taxable net income shall be the combined net income of the several corporations consolidated, except that the net income of corporations organized after August 1, 1914, and not a successor to a then existing business, coming within the provisions of Section 240 (a) of the law shall be taken out.

Different Fiscal Years of Affiliated Corporations.—In the case of all consolidated returns, consolidated invested capital must be computed as of the beginning of the taxable year of the parent or principal reporting company, and the consolidated income must be computed on the basis of its taxable year. Whenever the fiscal year of one or more subsidiary or other affiliated corporations differs from the fiscal year of the parent or principal corporation, the Commissioner should be fully advised by the taxpayer in order that provision may be made for assessing the tax in respect of the period prior to the beginning of the fiscal year of the parent or principal company.

TIME AND PLACE FOR FILING RETURNS

Returns of income must be filed on or before March 15, of each year, or the fifteenth day of the third month following the close of a fiscal year other than the calendar year. The due dates for returns for different accounting periods and the dates of payment of installments of taxes are as follows:

End of Taxable year	Last Date for Return and Date of First Payment	Date of Second Payment	Date of Third Payment	Date of Fourth Payment
Dec. 31	Mar. 15	June 15	Sept. 15	Dec. 15
Jan. 31	Apr. 15	July 15	Oct. 15	Jan. 15
Feb. 28	May 15	Aug. 15	Nov. 15	Feb. 15
Mar. 31	June 15	Sept. 15	Dec. 15	Mar. 15
Apr. 30	July 15	Oct. 15	Jan. 15	Apr. 15
May 13	Aug. 15	Nov. 15	Feb. 15	May 15
June 30	Sept. 15	Dec. 15	Mar. 15	June 15
July 31	Oct. 15	Jan. 15	Apr. 15	July 15
Aug. 31	Nov. 15	Feb. 15	May 15	Aug. 15
Sept. 30	Dec. 15	Mar. 15	June 15	Sept. 15
Oct. 31	Jan. 15	Apr. 15	July 15	Oct. 15
Nov. 30	Feb. 15	May 15	Aug. 15	Nov. 15

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A corporation going into liquidation, during any taxable year may, upon the completion of such liquidation, prepare a return covering its income for the fractional part of the year during which it was engaged in business and may file such return immediately.

Time for Filing Return upon Death or Termination of Trust.—As soon as possible after his appointment and qualification, an executor or administrator shall file a return of income for the decedent for the portion of the taxable year prior to death. Upon the completion of the administration and final accounting, an executor or administrator shall file a return of income of the estate for the portion of the taxable year in which the administration was closed, attaching to the return a certified copy of the order for his discharge. An ancillary administrator need make no separate return if the domiciliary administrator includes in his return the entire income of the estate.

Extension of Time by Collector.—In cases of sickness or absence, collectors are authorized to grant an extension of not exceeding 30 days, but the application for such extension must be made prior to the expiration of the period for which the extension is desired. The absence or sickness of one or more officers of a corporation will not be accepted as a reasonable cause for failure to file the return, unless there were no other principal officers available to make and verify the return.

Extension of Time by Commissioner.—If, before the end of an extension of 30 days granted by the collector, an accurate return cannot be made, an appeal for a further extension must be made to the Commissioner, but no such extension shall be granted beyond the original due date of the third installment of the tax. Either a complete or a tentative return must be submitted on or before the due date as extended, and the tax shown to be due paid at that time.

Extension of Time in the Case of Persons Abroad. An extension of time for filing returns of income for 1918 and subsequent years and for paying the tax is granted in the case of nonresident alien individuals and nonresident foreign corporations, or their proper representatives in the United States, and of American citizens residing or traveling abroad, including persons in military or naval service on duty outside the United States, for such period as may be necessary, not exceeding ninety days after proclamation by the President of the end of the war with Germany.

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The whole tax shown to be due must be paid at the time of filing the return. In all such cases an affidavit must be attached to the return, stating the causes of the delay in filing it.

Extension of Time in the Case of Enemies.—A like extension to the one described in the foregoing paragraph is also granted for filing returns of income for 1918 and subsequent years and for paying the tax by or for nonresident enemies or allies of enemies, as defined by Section 2 of the Trading-with-the-Enemy Act of October 6, 1917, not holding licenses granted under the provisions of that act.

This extension, however, does not authorize any delay in filing returns of information, and is also subject to the condition that all persons who on October 6, 1917, had or since have had or may hereafter have control of any money or other property for any such enemy or ally of enemy, or who on October 6, 1917, were or since have been, or thereafter became indebted to any such enemy or ally of enemy, shall hold and deliver all such money and property subject to the Trading-with-the-Enemy Act and to the orders of the President and of the Alien Property Custodian, thereunder, and shall file returns of income in respect thereto for such period as may elapse or have elapsed prior to the actual delivery of such money and property to the Alien Property Custodian.

Last Due Date.—The last due date is the last day upon which a return is required to be filed or the last day of the period covered by an extension of time duly granted. When it falls on Sunday or a legal holiday, the last due date will be the day following. If placed in the mails, the return should be posted in ample time to reach the collector's office on or before the date on which the return is required to be filed, but no penalty will attach should the return not be actually received by such officer until subsequent to that date.

Place of Filing.—Returns of income must be filed with the collector for the district in which the legal residence or principal place of business of the person making the return is located. Persons having no domicile or place of business in the United States, and persons in the military or naval service of the United States, may file their returns with the collector at Baltimore, Md.

A corporation having an office or agency in the United States must make its returns to the collector of the district in which is

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located its principal office or agency. Other corporations must make their returns to the collector at Baltimore.

Verification of Returns.—All income tax returns must be verified under oath or affirmation before an officer authorized to administer oaths. Returns executed abroad may be attested free of charge before United States consular officers. Where a foreign notary or other official having no seal shall act as attesting officer, his authority shall be certified to by some judicial official or other proper officer having knowledge of his appointment and official character.

Use of Prescribed Forms.—Copies of the prescribed return forms will so far as possible be furnished taxpayers by collectors. Failure on the part of any taxpayer to receive a blank form will not, however, excuse him from making a return. In lack of a prescribed form, a statement made by a taxpayer disclosing his gross income and the deductions therefrom may be accepted as a tentative return, and if filed within the prescribed time a return so made will relieve the taxpayer from liability to penalties, provided that without unnecessary delay such a tentative return is replaced by a return made on the proper form.

PAYMENT OF TAXES

Taxes, other than taxes paid at the source, are payable in four equal installments; the first at the time of filing the return and the others at intervals of three months thereafter. At the option of the taxpayer, the tax may be paid in a single payment, or if the time for filing the return has been extended, full payment may be made on or before the expiration of such extension. An unconditional extension of time for filing the return will postpone the date of payment of the first installment, but will not postpone the date of the payment of the other installments, unless so specified in each case.

If an installment of tax is not paid when due, all of the tax remaining becomes due and payable upon notice and demand. If upon recomputation of the tax it is found that the tax already paid exceeds the correct amount of the installment or of the whole tax, the excess shall be credited against subsequent installments or other similar taxes then due, or if no such installments or no such tax is due such excess shall be refunded to the taxpayer.

Interest on Tax.—Where the time for payment of any installment of tax is postponed at the taxpayer's request, interest at the rate of 6% per annum is added from the original due date. If an

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understatement of tax in the return is due to negligence, but without intent to defraud, interest at the rate of 12% per annum is added to the amount of the deficiency of each installment from the time the installment was due. If any tax remains due and unpaid for ten days after notice and demand, or in case the first installment, as computed by the taxpayer, remains due and unpaid for ten days, interest at the rate of 12% per annum is added from the due date, except that the interest on any amount which is the subject of a bona fide claim for abatement shall be at the rate of 6% per annum, and except that no interest is added in the case of estates of insane, deceased, or insolvent persons. If any part of a claim for abatement on the ground of a loss in inventory is disallowed, interest from the original due date at the rate of 12% per annum will be added to the tax not abated. Interest is also added when the demand for payment is made of the taxpayer personally, although he subsequently dies or becomes insane or insolvent, so that collection of the tax is made from his estate in the hands of his representative.

Notice and Demand of Payment.—Service of a notice and demand by the collector on Form 17 is complete upon mailing it, and the time within which the tax must be paid runs from the date of mailing the notice, and not of its receipt by the taxpayer. But payment for the tax must actually reach the collector within the ten-day period, and merely mailing the remittance before the expiration of ten days is not sufficient. In the case of taxpayers, however, who are absent from their homes or their places of business, in foreign countries, or in the military or other service of the United States, the collector will enter on the notice as the date on which the tax becomes due, a date as nearly as possible ten days after the time that the notice should be received by the taxpayer in the ordinary course of the mails. If it appears that a remittance for the tax was placed in the mail within the ten-day period or satisfactory evidence is produced to show that a notice was not delivered in due time, the penalty and interest will not be collected.

Payment of Tax by Uncertified Checks.—Collectors may accept uncertified checks in payment of income and excess profits taxes, provided such checks are collectible without any deduction for exchange or other charges. The day on which the collector receives the check will be considered the date of payment unless it is returned dishonored. If one check is remitted to cover two or more persons' taxes, the remittance must be accompanied by a letter of transmittal, stating

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(a) the name of the drawer of the check;
(b) the amount of the check;
(c) the amount of any cash, money order, or other instrument included in the same remittance;
(d) the name of each person whose tax is to be paid by the remittance;
(e) the amount of the payment on account of each person; and
(f) the kind of tax paid.

Payment of Tax by Certificates of Indebtedness.—United States Treasury Certificates of Indebtedness may be accepted by the collector in payment of taxes at par, with an adjustment for accrued interest.

CREDIT FOR TAXES

Individuals

Under the Revenue Act of 1918, the income tax of an individual shall be credited with:

(a) In the case of a citizen of the United States, whether resident or nonresident, the amount of any income, war profits and excess profits taxes paid or accrued during the taxable year to any foreign country upon income derived from sources therein, or to any possession of the United States;
(b) In the case of a resident of the United States, such taxes paid or accrued during the taxable year to a possession of the United States;
(c) In the case of an alien resident of the United States, the amount of any such taxes paid or accrued during the taxable year to the country of which he is a citizen or subject, upon income derived from sources therein, only if such country permits a similar credit to citizens of the United States residing in such country.

Subject to the foregoing limitations, the members of a partnership, the stockholders of a personal service corporation, or the beneficiaries of an estate or trust may take credit for their proportionate share of any such taxes which may have been paid by the partnership, personal service corporation, estate, or trust.

Meaning of Terms.—The term "amount of taxes paid during the taxable year" means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the individual claiming credit. "Foreign country" includes within its meaning any foreign sovereign state or self-governing colony (for example, the Dominion of Canada), but does not include a foreign municipality (for example, Montreal) unless itself a sovereign state (for example, Hamburg).

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"Any possession of the United States" includes, among others, Porto Rico, the Philippines, and the Virgin Islands.

Conditions of Allowance of Credit.—When credit is sought for income, war profits or excess profits taxes paid other than to the United States, the income tax return of the individual must be accompanied by Form 1116. When credit is sought for taxes already paid, the form must have attached to it the receipt for each such tax payment. When credit is sought for taxes accrued, the form must have attached to it the return on which each such accrued tax was based. The receipt or return so attached must be either the original, a duplicate original, a duly certified or authenticated copy, or a sworn copy. In case only a sworn copy of a receipt or return is attached, there must be kept readily available for comparison on request the original, a duplicate original or a duly certified or authenticated copy.

In the case of a credit sought for a tax accrued but not paid, in addition to Form 1116, the Commissionor may also require a bond in such penal sum as he may prescribe, conditioned for the payment by the taxpayer of any tax found due upon any redetermination of the tax made necessary by such credit proving incorrect, with such further conditions as the Commissioner may require. Form 1117 must be used when a bond is so required.

Redetermination of Tax When Credit Proves Incorrect.—In case credit has been given for taxes accrued, or a proportionate share thereof, and the amount that is actually paid on account of such taxes, or a proportionate share thereof, is not the same as the amount of such credit, or in case any tax payment credited is refunded in whole or in part, the taxpayer shall immediately notify the Commissioner. The Commissioner will thereupon redetermine the amount of the income tax of such taxpayer, and the amount of tax, if any, due upon such redetermination shall be paid by the taxpayer upon notice and demand by the collector.

Corporations

To secure a credit for taxes, a domestic corporation must pursue the same course as that prescribed for an individual, except that Form 1118 is to be used for claiming credit and Form 1119 for the bond, if a bond is required. The provisions with respect to the redetermination of tax when a return for such taxes has been rendered incorrect by later developments, apply also to a corporate taxpayer

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Domestic Corporation Affiliated With Foreign Corporation.—A domestic corporation which owns a majority of the voting stock of a foreign corporation is entitled to credit its income, war profits and excess profits taxes with any income, war profits or excess profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources within the United States in an amount equal to the proportion which the amount of any dividends (not deductible under Section 234), but not in excess thereof, received by such domestic corporation from such foreign corporation during the taxable year, bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid. A claim for credit in such a case is also to be made on Form 1118.

CLAIMS FOR ABATEMENT, REFUND AND CREDIT

The law provides different methods by which erroneous assessments may be corrected upon appeal to the Commissioner by the taxpayer. In any case where the taxpayer discovers that an error has been made in his return, an amended return should be filed. If an error is discovered or the taxpayer disputes a ruling of the Treasury Department after assessment is made and desires to correct the error prior to payment, a claim in abatement should be filed. If excessive tax has been paid under an erroneous or illegal assessment, recovery should be obtained by filing a claim for refund, or if taxes are due the Government by reason of another assessment, a claim for credit should be filed, requesting that the taxes illegally exacted should be applied to the assessment legally due. Failure to file a claim in abatement does not prevent recovery of tax after payment by claim for refund or credit. The method of correction of the error is optional; the taxpayer may proceed either before the tax is paid by claim for abatement, or if the tax has been paid, by claim for refund or credit. The fact that a claim in abatement has been filed and rejected does not preclude a subsequent claim for refund or credit.

Claims in Abatement.—Claims by the taxpayer for the abatement of taxes or penalties erroneously or illegally assessed, or abatable under remedial acts, should be made on Form 47, and must be sustained by affidavits of the parties against whom taxes were

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assessed or of other parties cognizant of the facts, and such affidavits should contain complete and explicit statements of all material facts relating to the claim. When the tax has been assessed and paid, the presumption is that the assessment was properly and legally assessed, and the burden of proof in rebutting the presumption and establishing the claim rests upon the claimant. The filing of a claim for abatement does not necessarily operate as a suspension of the collection of the tax, and in any case where the collector deems it necessary he may collect the tax and leave the taxpayer to his remedy by claim for refund.

Claims for Credit.—As heretofore stated, any amount of tax paid in excess of that properly due shall be credited against any such taxes due from the taxpayer under any other return. In order to obtain the benefit of such credit the regulations provide that where the credit demanded is equal to or less than any outstanding assessment of tax, the taxpayer shall file with the collector for the district in which his original return was filed a claim on Form 47-A, which shall be sworn to, and shall contain the following facts:

(a) Business engaged in by claimant;
(b) Character of assessment;
(c) Amount of tax paid and for what taxable year;
(d) Portion of tax under (c) claimed as a credit;
(e) Unpaid assessment against which credit is asked and for what taxable year; and
(f) All facts regarding the overpayment.

If the amount claimed as a credit is greater than the outstanding assessment of tax, the taxpayer shall file, in addition to Form 47-A, a claim for refund of the overpayment in excess of the credit. Such claim for refund may be attached to the claim for credit or may be separately filed with the Commissioner.

Claims for Refund.—Claims by the taxpayer for refund of taxes and penalties erroneously or illegally collected should be made on Form 46, under oath. The burden of proof in the case of a claim for refund, as in the case of a claim for abatement, rests upon the claimant. All facts in support of the claim should be clearly set forth and it should be accompanied by the collector's receipt or cancelled check, showing payment of the tax. In the case of a claim on behalf of a decedent taxpayer, certified copies of the letters of administration or letters testamentary or other similar evidence showing the authority of the administrator or executor should be annexed to the claim. In any case where the claim is made by an agent of the taxpayer it must be accompanied by a power of attorney.

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A taxpayer desiring to convert a claim for refund previously filed into a claim for credit may file with the collector a claim on Form 47-A, reference being made to such claim for refund. When received by the Commissioner, the claim for credit will be attached to the claim for refund and will be adjusted in the same manner as if the taxpayer had originally filed a claim for credit.

PENALTIES

A penalty of not more than $1,000 attaches for failure to punctually make a required return, whether of income, withholding, or information, or to pay or collect a required tax. If the failure is wilful, however, or an attempt is made to defeat or evade the tax, the offender is liable to imprisonment and to a fine of not more than $10,000 and costs. In addition to these specific penalties, ad valorem penalties are imposed in various cases. An ad valorem penalty is assessed and collected as a part of the tax, while a specific penalty is recoverable only by suit. See Section 250 of the statute.

Failure to File Return.—In case of failure to make a return on time, a penalty of 25% of the amount of the tax is added, unless the return is later filed and the failure to file is satisfactorily shown to be due to a reasonable cause. Two classes of delinquents are liable to the penalty: (a) those who do not file returns and for whom returns are made by a collector or the Commissioner; and (b) those who file tardy returns and are unable to show reasonable cause for the delay. Taxpayers wishing to avoid the penalty must make an affirmative showing of the facts alleged as a reasonable cause for failure to make a return on time in the form of an affidavit under oath, which should be attached to the return, and if the Commissioner determines that the delinquency was due to a reasonable cause the 25% penalty will not be assessed.

Understated Return.—(a) If an understatement of tax in a return of income is due to negligence, but without intent to defraud, a penalty of 5% of the amount of the deficiency is added; but (b) if the understatement is false with intent to evade the tax, a penalty of 50% of the deficiency is added. If a false or fraudulent return is wilfully made, other than as specified in (b) above, a penalty of 50% of the amount of the tax is added. (See Section 3176 Revised Statutes.)

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PART IV. EXCESS PROFITS TAX

Imposition of Tax

The Act of 1918 imposes a straight excess profits tax on corporations, for the year 1919. The war profits tax, effective for the calendar year 1918, extends in 1919 only to corporations receiving net income of $10,000 or more from Government contracts, and to corporations with a fiscal year beginning in 1918 and ending in 1919. Inasmuch as this latter class of corporations is comparatively small and this booklet deals principally with returns for the taxable year 1919, the discussion of the excess profits tax, except in a few instances, omits reference to the war profits tax.

Under the excess profits tax for 1919, individuals and partnerships are exempt from tax. All corporations except the following are subject to tax:

(a) Certain classes of corporations not organised for profit, which are exempt from income tax under Section 231 of the law,

(b) Net income of corporations derived from the mining of gold,

(c) Personal service corporations,

(d) Corporations whose net income for the full taxable year is less than $3,000. A corporation rendering a return for a fractional part of a year, whose net income is less than the same proportion of $3,000 as the number of months in the period is of twelve months, is exempt from excess profits tax. For the purpose of this computation, a fractional part of a month will be counted as the number of days in such part of a month divided by 30.

Computation of Tax.—The excess profits tax, like the income tax, is a tax on net income. The rates of tax for 1919 and thereafter, except in the case of a corporation which derives in any taxable year after 1918, a net income of more than $10,000 from any Government contracts made after April 5, 1917, and before November 12, 1918, are as follows:

FIRST BRACKET: 20 per centum of the net income in excess of the excess profits credit and not in excess of 20 per centum of the invested capital;

SECOND BRACKET: 40 per centum of the net income in excess of 20 per centum of the invested capital.

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As applied to a specific case, the excess profits tax and the income tax for 1919 of a corporation is computed as follows:

Net Income for Taxable Year.....		$250,000
Invested Capital for Taxable Year...		700,000
Excess Profits Credit (See page 119.).		59,000
COMPUTATION OF TAX		
FIRST BRACKET: 20% of ($140,000 less $59,000)...	$81,000	$16,200
SECOND BRACKET: 40% of..	110,000	44,000
Total Excess Profits Tax.....		60,200
Income Tax at 10% of ($250,000 less $62,200)...	187,800	18,780
Total.....		$78,980

In order to compute the excess profits tax for 1919, it is not necessary to give any data for the prewar period, either as to net income or invested capital. For any taxable year ending in 1919 other than December 31, 1919, it is necessary to compute the tax both under the rates effective for 1918 and the rates effective for 1919 in order to determine the tax due for the fiscal year (See Form 1120-A).

Return for Less Than a Year.—The following illustrates the computation of excess profits tax where a return is made for a period of six months.

Invested Capital.....	$120,000
Net Income.....	50,000

The excess profits credit is computed by adding the specific exemption of $3,000 to 8 per centum of the full invested capital of $120,000, or $9,600, a total of $12,600, and taking 6/12 of this result, or $6,300, as the excess profits credit.

FIRST BRACKET.—The amount of the net income ($50,000) in excess of the excess profits credit ($6,300) and not in excess of 6/12 of 20 per centum of the invested capital (i. e., 6/12 of 20 per centum of $120,000), or $12,000, is $5,700. The tax computed under this bracket is 20 per centum of this amount (i. e., 20 per centum of $5,700), or $1,140.

SECOND BRACKET.—The amount of the net income ($50,000) in excess of 6/12 of 20 per centum of the invested capital (i. e., 6/12 of 20 per centum of $120,000), or $12,000, is $38,000. The tax computed under this bracket is 40 per centum of this amount (i. e., 40 per centum of $38,000), or $15,200.

The total excess profits tax will be the sum of the taxes computed under the two brackets (i. e., $1,140 plus $15,200), or $16,340.

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Income in Part from Business with Invested Capital.—By the terms of Section 303 of the statute, a special method of assessment is made applicable to a corporation which derives income from business with invested capital and from a business without invested capital, the net income of which latter business constitutes not less than 30 per centum of the entire net income of such corporation and which, if transacted alone, would class it as a personal service corporation. In such cases the tax upon the net income from each class of business is computed separately. The tax upon the income from the business with invested capital is computed upon the basis of

(a) Such part of the entire invested capital for the taxable year as has been employed in the production of the net income upon which the tax is being computed; and

(b) The same proportion of the specific exemption and excess profits credit which the part of the net income upon which the tax is being computed is of the entire net income.

The tax upon the personal service part of the net income is the same percentage thereof as the tax computed on the net income from business with invested capital is of the net income of such business with invested capital. This tax, however, shall, in no case, be less than 20 per centum of the personal service part of the entire net income, unless the tax upon the entire net income if computed in the ordinary way would be less than 20 per centum of such entire net income. In that event, and in any case in which the amount of the total tax as computed under this provision is the same as or greater than the tax as computed in the ordinary way, the tax shall be computed under Section 301 of the statute.

The following is an illustration of the computation of tax where income is partly derived from business with invested capital and partly from business without invested capital:

A corporation engaged in contracting work in which the employment of capital is necessary, also renders consulting engineering service, a personal service business which if constituting its sole business would bring it within the class of personal service corporations.

Invested Capital used in Contracting.	$81,000	
Invested Capital used in Engineering.	19,000	
Total Invested Capital.....		$100,000
Net Income Derived from Contracting	$30,000	
Net Income Derived from Engineering	60,000	
Total Net Income.....		90,000

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Tax on Net Income from Contracting:

Excess Profits Credit $1,000 (same proportion of $3,000 as $30,000 is of $90,000) plus 8% of $81,000, or $6,480, a Total Credit of $7,480.		
First Bracket—20% of $8,720 ($16,200 less $7.480)	$1,744	
Second Bracket—40% of $13,800	5,520	
Tax on Net Income from Contracting		$7,264

Tax on Net Income from Engineering:

Tax on Net Income from Contracting is 24.21% of $30,000 (Net Income from Contracting); therefore, Tax on Net Income from Engineering is 24.21% of $60,000 or	14,526	
Total Tax on Net Income from Entire Business		$21,790

Apportionment of Invested Capital.—For the purpose of determining whether or not a corporation partly partaking of the nature of a personal service corporation is within the scope of Section 303 of the statute and also for the purpose of establishing the basis for the computation of the tax, the corporation shall apportion or allocate its invested capital between each trade or business or branch thereof as nearly as may be in accordance with the actual facts, and shall submit with its return an explanatory statement setting forth the manner in which the apportionment of the invested capital employed in the production of each part of its net income has been determined. There must be assigned to any personal service trade or business or branch thereof an amount of invested capital at least as great as that which would ordinarily be employed by a personal service corporation of similar size and standing for the payment of salaries and office expenses, maintenance of library and equipment, credit advances to clients, etc.

Apportionment of Net Income.—Whenever it is necessary to determine the portion of the net income derived from or attributable to a particular source, the corporation shall allocate to the gross income derived from each source the expenses, losses, and other deductions properly appertaining thereto, and shall apply any general expenses, losses, and deductions (which cannot otherwise be properly apportioned) ratably to the gross income from all sources. The gross income derived from a particular source, less

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the deductions properly appertaining thereto and less its proportion of any general deductions, is the net income derived from such source. A corporation is required in such cases to submit with its return a statement fully explaining the manner in which such expenses, losses and deductions were allocated or distributed.

Income from Gold Mining.—If a corporation is engaged in the mining of gold, the portion of its net income derived from that source is exempt from tax. The tax on the remaining portion of its net income is the proportion of the tax that would have been payable had the entire net income been derived from other sources than the mining of gold, which such remaining portion of the net income bears to the entire net income. To determine the net income derived from each source, the method explained on page 114 should be followed.

The following is an illustration of the computation of the tax of a corporation, part of whose income is derived from the mining of gold.

In the case of the corporation used as an illustration on page 112, let it be assumed that it is engaged in the mining both of gold and of other rare metals; that the Commissioner finds that $100,000 of the net income was attributable to the mining of gold and exempt from tax. The remaining portion of the net income is $150,000 and the tax thereon is the same proportion of the tax computed on the entire net income without the benefit of the exemption (i. e., a tax of $60,200) which the remaining portion of the net income ($150,000) bears to the entire net income ($250,000). The tax will therefore be three-fifths of the tax of $60,200, computed without the benefit of the exemption, or $36,120.

Sale of Mineral Deposits.—In order to encourage prospecting and exploration or discovery work, under Section 337 of the Act of 1918, Congress placed a limitation on the tax on the sale of mines, oil or gas wells. The law provides that in the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the taxpayer, by prospecting and locating claims, or by exploring and discovering undeveloped claims, has demonstrated the principal value of such mines or wells, which, prior to his efforts had a merely nominal value, the portion of the excess profits tax attributable to such a sale shall not exceed 20 per centum of the selling price. To determine the application of this provision to a particular case, the corporation should compute the excess profits tax in the ordinary way upon its net income, including its net income from any such sale. The proportion of the total tax indicated by the ratio which the tax-

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payer's net income from the sale of the property, bears to its total net income, is the portion of the tax attributable to such sale, and if it exceeds 20 per centum of the selling price of the property such portion of the tax shall be reduced to that amount. To determine the net income derived from each source, the method explained on page 114 should be followed.

In the case of the corporation used as an illustration on page 112, let it be assumed that its net income for 1919 included $100,000 derived from a bona fide sale of an oil well at $120,000, the principal value of which had been demonstrated by exploration and discovery work done by the corporation. The portion of the net income attributable to the sale, namely $100,000, is 40 per centum of the entire net income of $250,000 and the portion of the tax for that year attributable to the sale will be 40 per centum of the entire tax of $60,200, or $24,080. But, this portion of the tax cannot exceed 20 per centum of the selling price, $120,000, and is accordingly reduced to $24,000. The total tax will be $36,120 (the portion of the tax not affected) plus $24,000, or $60,120 (instead of $60,200).

Computation of Tax on Income from Government Contracts after 1918.—If a corporation derives in any taxable year after 1918 net income of more than $10,000 from any Government contracts made after April 5, 1917, and before November 12, 1918, the tax shall be such a proportion of a tax computed at the rates for 1918 as the portion of the net income attributable to the Government contracts bears to the entire net income, plus such a proportion of a tax computed at the rates for 1919 as the amount of the remaining net income bears to the entire net income. In computing such taxes, however, the excess profits credit and the war profits credit applicable to the taxable year shall be used. The method of determining the net income attributable to such contracts is the same as that explained on page 114.

Limitation on Tax.—Protection is afforded small corporations from excessive payments by placing a limitation on the amount of tax which may be collected. For the year 1919 and thereafter, the tax shall not exceed the sum of 20 per centum of the net income in excess of $3,000 and not in excess of $20,000, plus 40 per centum of the net income in excess of $20,000. This limitation is of especial importance to corporations having a small income and small invested capital. For example, a corporation with a net income for the taxable year 1919 of $20,000, and invested

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capital of $5,000, would be subject to a tax of $6,640 if computed in the ordinary manner, the method of computation being as follows:

Net Income		$20,000
Credit		
8% of Invested Capital	$400	
Specific Exemption	3,000	
Total	3,400	
Income Taxable at 20%		None
Income Taxable at 40%		16,600
Excess Profits Tax		6,640

The limitation, however, confines this tax to 20 per centum of $17,000, or $3,400.

When a return is rendered for a fractional part of a year, the limitation is computed by taking that proportion of $3,000 and of $20,000, respectively, which the period covered by the return bears to a full year. The rates of tax, however, are not affected and should be applied as in the ordinary case.

It is specifically provided that nothing contained in the law providing for this limitation shall be construed so as to increase the tax imposed in the regular manner.

Computation of Tax in Special Cases.—Section 328 of the law provides that in certain cases, the tax will be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of foreign corporations, the tax shall be computed without deducting a specific exemption of $3,000, either for the taxpayer or the representative corporations.

Cases Falling Under Section 328.—The law provides that assessment under Section 328 shall be made in the following cases:

(a) Where the Commissioner is unable to determine the invested capital of the corporation;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds;

(d) Where, upon application by the corporation, the Commissioner finds that the tax if determined in the ordinary way would, on account of abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship

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evidenced by gross disproportion between the tax so computed and the tax computed by reference to the representative corporations specified in Section 328.

This special method of computation does not apply to any case under subdivision (d) above in which (1) the tax computed in the ordinary way is high merely because the corporation earned within the taxable year a high rate of profits upon a normal invested capital; nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year consists of income derived on a cost-plus basis from a Government contract made between April 6, 1917, and November 11, 1918, both dates inclusive.

The tax will not ordinarily be computed under Section 328 merely because the form or manner of organization of the corporation, or the limitations imposed by Section 326, result in a greater tax than would otherwise be payable.

A corporation which comes within the provisions of subdivision (d) of Section 327 may make application for assessment under the provisions of Section 328. This application, which must be attached to the corporation's return, must set forth in full (a) the reasons why the tax should be so determined; (b) the facts upon which such reasons are based; (c) an exact description of each trade or business or important branch of a trade or business carried on by it; (d) amount of invested capital and net income for each year from the beginning of the prewar period; (e) amount of gains, profits, commissions, or other income derived on a cost plus basis from Government contracts made after April 5, 1917, and before November 12, 1918, and the percentage which such income is of the total income of the corporation.

Determination by Commissioner.—The Commissioner will determine in each case as nearly as may be the group or class of corporations with which the corporation should be compared and the amount which bears the same ratio to the net income of the corporation (in excess of the specific exemption of $3,000) for the taxable year as the average tax of such representative corporations bears to their average net income (in excess of the specific exemption of $3,000) for such year. The comparison will take account of similarity with respect to gross income, net income, profit per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

First Installment of Tax.—In the case of any corporation, other than a foreign corporation, where absolutely no data are avail-

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able for the determination of the invested capital for the taxable year, the installments of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax equal to 50%* of the net income. In any other case under Section 328 of the statute, other than the case of a foreign corporation, but including a case where the invested capital for the taxable year cannot be accurately determined, but where a minimum amount of invested capital as to which there is no question can be determined, the installments shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using the minimum invested capital, such tax not to exceed an amount equal to 50%* of the net income.

Foreign Corporation, Determination of First Installment.—In the case of a foreign corporation, the installments, of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using its invested capital for the taxable year 1917, such tax not to exceed an amount equal to 50%* of the net income. For the purpose of this article the invested capital for 1917 shall be adjusted for any subsequent changes in its amount due to cash or property paid in or withdrawn or to surplus or undivided profits of prior years retained in the business and properly attributable to its business within the United States. If the tax for 1917 was determined under Section 210 of the Revenue Act of 1917, the constructive capital which would result in a tax equivalent to the tax determined under that section shall be used.

Payment of Tax in Special Cases.—In the foregoing cases, the installments shall be paid upon the basis as indicated, until the Commissioner notifies the corporation of the amount of tax computed under Section 328. The installments shall then be recomputed upon the basis of a war profits and excess profits tax of such amount, and if the amount already paid is less than the amount which would have already become due if the installments had originally been computed upon that basis, the additional amount shall be due and payable ten days after notice and demand from the collector.

Credit.—The excess profits credit consists of the specific exemption of $3,000, plus an amount equal to 8 per centum of the invested capital for the taxable year. A foreign corporation is not entitled to the specific exemption of $3,000. Affiliated corporations making a

* A ruling dated January 22, 1919, holds that, in claims for assessment under Sec. 328 for 1919, tax shall not exceed 40% of net income.

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consolidated return are allowed but one specific exemption of $8,000. If any part of the excess profits credit is not allowed under the first bracket, because such credit is in excess of 20 per centum of the invested capital of the corporation, the balance thereof may be deducted from the amount of the income taxable in the second bracket.

The excess profits credit is used only in determining the excess profits tax. Where it is necessary to compute the war profits tax because of income derived from Government contracts, the computation should be made in accordance with Section 311 of Title III of the Revenue Act of 1918. See pages 175 and 176.

INVESTED CAPITAL

The computation of invested capital is based upon the cash or other property put into the business, plus the earned surplus and undivided profits, exclusive of earnings for the current taxable year, and is not affected by the present valuation or appraisal of the assets. Borrowed money or property, whether represented by bonds, notes, open accounts or otherwise, is specifically excluded. The fair market value of assets as of March 1, 1913, has no bearing on invested capital.

What Invested Capital Includes.—Invested capital, as defined in the taxing act of 1918, includes:

(1) Actual cash bona fide paid in for stock;

(2) Actual cash value at the time of payment, of tangible property bona fide paid in for stock but not in excess of the par value of stock issued therefor, unless such cash value is substantially in excess of the par value, in which case such excess shall be treated as paid in surplus;

(3) Paid-in or earned surplus and undivided profits, exclusive of earnings during the taxable year.

(4) Intangible property bona fide paid in for stock prior to March 3, 1917, not in excess of the lowest of the following three values:

(a) Actual cash value of the property when paid in,

(b) Par value of stock issued therefor, or

(c) In the aggregate, 25 per centum of the par value of the stock of the corporation, outstanding on March 3, 1917;

(5) Intangible property bona fide paid in for stock on or after March 3, 1917, not in excess of the lowest of the following three values:

(a) Actual cash value of property when paid in,

(b) Par value of stock issued therefor, or

(c) In the aggregate, 25 per centum of the par value of the stock of the corporation, outstanding at the beginning of the taxable year.

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The total amount which may be included in invested capital on account of intangible property paid in for stock must not exceed, in the aggregate, 25 per centum of the par value of the stock of the corporation outstanding at the beginning of the taxable year.

Adjustment of Book Accounts and Other Measures of Value.—The invested capital, as determined by the taxing act, may differ from the capital as shown on the books of the corporation, but in such event, no changes should be made in the books themselves. The corporation should, however, in all cases, keep a permanent record of the adjustments which are made in computing invested capital in order that the taxpayer's books and the statement of invested capital may be reconciled.

The invested capital is based upon the actual investment of the stockholders in the corporation, irrespective of the present value of its assets. In the case of the capital stock tax imposed by Section 1000 of the 1918 law, the fair value looks to the present value of the corporation's assets, irrespective of the amount of the investment of the stockholders therein. Accordingly, the amount determined as the fair value of the capital stock for the purpose of the capital stock tax has no bearing upon the determination of invested capital.

Tangible and Intangible Property Defined.—Intangible property includes patents, copyrights, secret processes and formulæ, good will, trade-marks, trade-brands, franchises, and other like property. Tangible property means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds and property other than intangible property.

Most contracts are intangible property and in the absence of a specific ruling by the Commissioner to the contrary, should be so regarded for the purpose of making returns. Associated Press, United Press and similar franchises, and subscription lists and mailing lists, are intangible property under the regulations of the Department.

Tangible Property Paid In: Evidences of Indebtedness.—Enforcible notes or other evidences of indebtedness, whether interest-bearing or non-interest-bearing, of the subscriber received by a corporation upon a subscription for stock may be considered as tangible property in computing its invested capital to the extent of the actual cash value of such notes or other evidences of indebtedness at the time when paid in, but only if such notes or evidences of indebtedness could be legally received in pay-

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ment for stock under the laws of the jurisdiction in which the corporation was organized, and if they were actually received by the corporation as absolute and not as conditional payment in whole or in part of the stock subscription.

Intangible Property Paid In.—The actual cash value of intangible property paid in for stock or shares must be determined in the light of the facts in each case. Among the factors to be considered are

(a) The earnings attributable to such intangible assets while in the hands of the predecessor owner;
(b) The earnings of the corporation attributable to the intangible assets after the date of their acquisition;
(c) Representative sales of the stock of the corporation at or about the date of the acquisition of the intangible assets; and,
(d) Any cash offers for the purchase of the business, including the intangible property, at or about the time of acquisition.

A corporation claiming a value for the intangible property paid in for stock or shares should file with its return a full statement of the facts relating to such valuation.

Mixed Tangible and Intangible Property.—If stock or shares, and bonds or other obligations have been issued for a mixed aggregate of tangible and intangible property, it will be presumed in the absence of satisfactory evidence to the contrary, that the bonds were issued for tangible property and that the stock was issued for the balance of the tangible property, if any, and for the intangible property. If stock or shares have been issued for a mixed aggregate of tangible and intangible property and certain liabilities have been assumed in connection with the transaction, it will be presumed that such liabilities are to be charged against the tangible property and the intangible property in the order named, unless it is shown by evidence satisfactory to the Commissioner that this presumption is not in accordance with the facts.

Where a mixed aggregate of tangible property and intangible property has been paid in for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively, the tax shall be assessed under the provisions of Section 328.

Cash or Tangible Property Paid In.—Capital and surplus actually paid in cash for tangible property constitute invested capital at their value at the time when paid in.

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Capital stock issued as a bonus in connection with the sale of a corporation's bonds may not be included in invested capital unless the corporation proves to the satisfaction of the Commissioner that such stock bonus enabled the corporation to secure a higher price for the bonds than it could otherwise have secured. Wherever this fact is established such stock may be included, in computing invested capital, to the extent of the difference between the selling price of the bonds and the price at which they could have been sold if issued without such stock bonus.

Tangible Property Paid In at Value in Excess of Par Value of Stock Issued Therefor.—Evidence offered to support a claim for a paid-in surplus must be as of the date of the payment and may consist, among other things, of

(a) An appraisal of the property by disinterested authorities made on or about the date of the transaction;

(b) Certification of the assessed value in the case of real estate; and

(c) Proof of a market price in excess of the par value of the stock or shares.

Additional value allowed in any case is limited to the value definitely known or accurately ascertainable at the time of the payment. No claim will be allowed for a paid-in surplus in a case in which the additional value has been developed or ascertained subsequently to the date when the property was paid in to the corporation or in respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as, for example, at a receiver's sale. Generally, allowable claims under this provision will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation. In all cases the proof of value must be clear and explicit.

Paid-In Surplus.—Where satisfactory evidence is shown to the Commissioner that tangible property has been paid in by a stockholder to a corporation as a gift, or at a value definitely known or accurately ascertainable as of the date of such payment clearly and substantially in excess of the cash or other consideration paid by the corporation therefor, then the amount of the excess shall be deemed to be paid-in surplus. Substantially the same kind of evidence is required in this case as in the case of tangible property paid in for stock at a value in excess of the par value of the stock issued therefor.

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Inadmissible Assets Paid In.—Stocks, bonds, and other obligations (other than obligations of the United States), the dividends or interest from which are not included in computing net income, hereafter described as inadmissible assets, when bona fide paid in for stock or shares, like other tangible property, may be included in computing the invested capital of the corporation at their actual cash value when paid in. For the purpose of the reduction required on account of inadmissible assets, however, account must be taken of such assets in the same manner as of any other inadmissible assets.

Impairment of Capital.—Except where there has been directly or indirectly a liquidation or return of investment to the stockholders, capital or surplus actually paid in is not required to be reduced because of an impairment of capital in the nature of an operating deficit. Thus, no deduction is necessary from capital and surplus paid in on account of a deficit due to losses, expense, depletion, depreciation or other causes. Before, however, its invested capital may be increased by surplus earnings or profits, the deficit must be made up.

Where, however, a corporation purchases its own stock, or where stock is surrendered by a stockholder, adjustment must be made to capital regardless of the existence of a surplus.

Property Paid In and Written Off.—If tangible or intangible property, which has been paid in to a corporation for stock or shares or as paid-in surplus, has been written off either wholly or in part, the amount so written off may be restored to capital or surplus account, upon evidence satisfactory to the Commissioner, except that

(1) The amount restored must be reduced by a proper deduction for any depreciation, obsolescence or depletion; and
(2) The aggregate amount included in computing invested capital on account of such property shall not exceed the amount which might have been included if such property had not been written off.

Current Earnings—Profits earned during the taxable year cannot be included in invested capital for such year. This is true even though, during the year, such profits are set up as surplus on the books or assumed to be distributed in the form of stock dividends. If a dividend is declared and paid during any year out of the profits of that year and the stockholders pay back into the corporation all or a substantial part of the amount of such dividends, the amount so paid back cannot be included in the computa-

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tion of invested capital, unless the corporation shows by evidence satisfactory to the Commissioner that the dividends were paid in good faith and without any understanding, express or implied, that they were to be paid back.

Adjustment of Surplus and Undivided Profits.—The regulations provide that only true earned surplus and undivided profits can be included in the computation of invested capital, and if for any reason the books do not properly reflect the true surplus, such adjustments must be made as are necessary in order to arrive at the correct amount. In the computation of earned surplus and undivided profits full recognition must first be given to all expenses incurred and losses sustained from the original organization of the corporation down to the taxable year, including among such expenses and losses reasonable allowance for depreciation, obsolescence or depletion of property (irrespective of the manner in which such property was originally acquired), and for the amortization of any discount on its bonds. Where adequate evidence is presented that the amounts written off or deducted in previous returns of net income are in the aggregate incorrect or unreasonable, adjustments must be made, and the taxpayer will be allowed a refund in respect of any taxes overpaid in prior years, or, in the case of an underpayment of taxes, will be additionally assessed.

Depletion, like depreciation, must be recognized in all cases in which it occurs. Depletion attaches to each unit of mineral or other property removed, and the denial of a deduction in computing net income under the Act of August 5, 1909, or the limitation upon the amount of the deduction allowed under the Act of October 3, 1913, does not relieve the corporation of its obligation to make proper provision for depletion of its property in computing its surplus and undivided profits. Adjustments in respect of depreciation or depletion in prior years will be made or permitted only upon the basis of affirmative evidence that as at the beginning of the taxable year the amount of depreciation or depletion written off in prior years was insufficient or excessive, as the case may be. Where deductions for depreciation or depletion have either on the books of the corporation or in its returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return.

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Reserves in General.—Reserves which are not allowed as deductions in the corporation's income tax return, such as reserves for contingent losses, for bad debts, for market fluctuations in securities, and for similar purposes, may be included in invested capital. As actual deductions on account of the foregoing may be made only in the year in which sustained, they are charged against current earnings, and the amount of the reserve at the beginning of the year may form a part of the invested capital for the entire taxable year.

The reserve funds of insurance companies, the net additions to which are deductible from gross income under Section 234 of the law, cannot be included in computing invested capital.

Reserves for Depreciation and Depletion.—If reserves for depreciation or depletion are included in the surplus account, it should be analyzed so as to separate such reserves and leave only real surplus. The regulations provide that such reserves may be included in invested capital only, as follows:

(1) Excessive depletion or depreciation included therein and which if charged off could be restored to surplus under the regulations (Art. 840) may be included in the corporation's invested capital; and

(2) Where depreciation or depletion is computed on the value as of March 1, 1913, or as of any subsequent date, the proportion of depreciation or depletion representing the realization of appreciation of value at March 1, 1913, or such subsequent date, may, if undistributed and used or employed in the business be treated as surplus and included in the computation of invested capital.

Reserve for Income Tax.—Income and war profits and excess profits taxes are deemed to have been paid out of the net income of the taxable year for which levied. The effect of this ruling is to require a deduction from the invested capital, as of the beginning of the year, for such taxes, averaged for the proportionate part of the taxable year subsequent to the date upon which such taxes are due and payable.

If, for any reason, the amount of any such tax for the preceding year is subsequently changed, a corresponding adjustment will be made in the invested capital for the taxable year upon the same basis as if the corrected amount of the tax for the preceding year had been used in the original computation of the invested capital for the taxable year.

Additions to Surplus Account.—Although the books of a corporation will be presumed to show the facts, certain additions

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to surplus and undivided profits are permitted under the regulations. The burden of proof, however, is upon the corporation claiming the additions to show that its capital or surplus account is understated. The regulations provide for the acceptance of additions to the following extent:

(1) Excessive depreciation heretofore charged off on property still owned and in use, if it is now shown by satisfactory proof to have been excessive and such excess is substantial in amount, whether or not disallowed by the Commissioner as a deduction from net income, may be restored to the surplus account. No such amount shall be restored, however, unless it is shown that adequate depreciation has been deducted upon all other property of the corporation still in use, nor in any case in which such amount has been allowed as a deduction for amortization under paragraph 8, Section 234 (a) of the statute, or in which the cost of the property has been recovered through being included in the price of goods or services, as for example, in the case of patterns, dies, plates, special tools, etc., or under a munition contract with a foreign government.

(2) Amounts which have been expended before January 1, 1917, for the acquisition of plant, equipment, tools, patterns, furniture, fixtures, or like tangible property, having a useful life extending substantially beyond the year in which the expenditure was made, and which have been charged as current expense, may (less proper deductions for depreciation or obsolescence) be added to the surplus account when such assets are still owned and in active use by the corporation during the taxable year. Special tools, patterns, and similar assets, shall not be assigned any value if their cost has been recovered through having been included in the price of goods. If their cost has not been so recovered and they are held for only occasional use, they shall not be assigned a value in excess of the fair value based upon the earnings actually arising from their current use, and in no case shall such value be more than the cost less depreciation. Assets of this kind not in current use shall not be valued at more than their nominal or scrap value.

(3) Amounts which have been expended in the past for intangible property of any kind may be restored to capital or surplus account only to the extent that the corporation specifically paid such amounts for the intangible property as such.

(4) Adjustments necessary to correct other errors found in the books of account may be made.

Limitations to Additions to Surplus Account.—Adjustments which are intended to correct returns of net income for prior years in which actual errors have been made, as for example, where excessive depreciation has been deducted, additions to plant and equipment, or other capital charges have been charged off as an expense, inventories have been taken upon a wrong basis of valuation, etc., will be permitted for all years, whether before or

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after March 1, 1913, if amended returns of net income are filed for each year in which an erroneous return has been made.

A corporation cannot, however, reinstate in surplus account deductions from income which are as a matter of good accounting optional, such as experimental expenses, patent litigation, development of good will through advertising or otherwise, etc. In these cases it is considered that the corporation has exercised a binding option in deducting such expenses from income, and such an election, made concurrently with the transaction, cannot later be revised and amended returns accepted.

Patents.—Adjustment of surplus account on account of patents which have been acquired either for stock or shares, or for cash or other tangible property is made dependent to a large extent upon the manner in which the asset has been handled on the books of the corporation. The Department has laid down definite rules for the treatment of patents in Article 843 of Regulations 45.

Discount on Bonds, etc.—If, under incorrect accounting practices, discount allowed on the sale of bonds has been charged to a property account or otherwise carried as an asset, and is so reflected in the surplus account, it is necessary, in computing invested capital, to make an adjustment in respect of such discount.

Only the amount of discount which has actually been reported by a bank in a prior year as taxable income and credited to surplus account may be included in surplus as of the beginning of the taxable year.

Cash Value of Insurance on Officers, etc.—In case insurance is carried by a corporation on the life of an officer or employee, the policy may be included as an admissible asset and reflected in the surplus account at the cash surrender value at the beginning of the taxable year. Real or personal property taken by a corporation in payment or satisfaction of a debt, or property received in exchange for property, is an admissible asset at its fair market value upon receipt. The profit or loss, however, resulting from the transaction will not be reflected in invested capital until the succeeding taxable year.

Borrowed Capital Defined.—The law expressly excludes from invested capital all borrowed capital, which is defined in the law as money or other property borrowed, whether represented by bonds, notes, open accounts or otherwise. Any interest in a corporation represented by bonds, debentures or other securities, by

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whatever name called, including so-called preferred stock, if with respect to the payment of either interest or principal it ranks with or prior to the interest of the general creditors, is borrowed capital and cannot be included in computing invested capital. Any such preferred stock may, however, be so included if it is deferred with respect to the payment of both interest and principal to the interest of the general creditors. Items such as deposits or amounts due to other banks shown in the balance sheet of a bank, unexpired subscriptions shown in the balance sheet of a publishing concern, etc., are deemed liabilities and cannot be included in computing invested capital.

The question often arises as to whether a given amount paid into or left in the business of a corporation represents borrowed capital or paid-in surplus. This is largely a question of fact. Indebtedness actually cancelled and left in the business would ordinarily constitute paid-in surplus, while amounts left in the business representing salaries of officers in excess of their actual withdrawals, or deposit accounts in favor of partners in a partnership succeeded by a corporation would be considered paid-in surplus or borrowed capital, according to the facts of the particular case. The general principle is that if interest is paid or is to be paid on any such amount, or if the stockholder's or officer's right to repayment of such amount ranks with or before that of the general creditors of the corporation, the amount so left with the corporation must be considered as borrowed capital and must be so treated in computing invested capital.

Inadmissible Assets Defined.—Stocks, bonds and other obligations (other than obligations of the United States), the dividends or interest from which are not required to be included in computing net income, are inadmissible assets, even though no such dividends or interest have been actually paid or received during the taxable year. The failure to pay or to receive dividends or interest does not change the status of such securities as inadmissible assets. A corporation cannot, by including the income from inadmissible assets as taxable income, create the right to have such assets considered admissible assets.

Obligations of a state or territory or any municipal or other political subdivision thereof, or the District of Columbia, or of any possession of the United States, and Federal reserve bank stock,

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Federal Farm Loan bonds, and bonds of the War Finance Corporation up to $5,000 (the amount of principal the income from which is exempt from income and excess profits taxes), not being obligations of the United States within the meaning of the statute, are inadmissible assets. In case the income derived from inadmissible assets consists in part of profit from the disposition thereof, or where all or a part of the interest derived from such assets is in effect included in net income because the interest paid on indebtedness incurred or continued to purchase or carry such assets may not be deducted from gross income, in either case a corresponding part of the capital invested in such assets shall be deemed an admissible asset. The foregoing applies separately to each issue or class of inadmissible securities held by a corporation. For example, it may hold A company stock costing $100,000 and B company stock costing $200,000. During the year it receives $8,000 in dividends from A company and $5,000 from B company, and on September 30 sells part of its B company stock at a profit of $3,000. For the period from January 1 to September 30, $75,000 of its holdings of B company stock become admissible. After September 30, its remaining holdings of B company stock are inadmissible, but the proceeds of the sale are admissible, unless invested in inadmissibles.

Admissible Assets Defined.—Admissible assets include all assets other than inadmissible assets. Organization expenses and deferred charges against future income are admissible assets. For all purposes of computing invested capital, admissible assets must be valued in accordance with the provisions of Sections 326, 330 and 331 of the statute. Thus, for example, intangible property paid in for stock is an admissible asset, but it cannot be valued at an amount in excess of that at which it may be included in computing invested capital under paragraphs (4) and (5) of Section 326 (a).

Deduction on Account of Inadmissible Assets.—The 1918 law provides that there shall be deducted from invested capital as defined, after all adjustments to capital and surplus have been made, a percentage thereof equal to the percentage which the amount of the inadmissible assets is of the amount of admissible and inadmissible assets held during the taxable year. For example, take a corporation having assets and liabilities as follows:

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(Corporation Balance Sheet December 31, 1918)

Assets		*Liabilities*	
Plant.....	$250,000	Capital Stock (Paid in).....	$150,000
Inventory.....	175,000	Surplus.....	25,000
Liberty Bonds....	25,000	Undivided Profits	25,000
State of N. Y. Bonds.....	25,000	Notes Payable...	200,000
Cash.....	25,000	Bills Payable....	100,000
Total.....	$500,000	Total.....	$500,000

In the case of the above corporation, the capital, surplus and undivided profits amount to $200,000 which represents the invested capital of the corporation as defined in the law. Included in the assets of the corporation, however, are State bonds of the cost value of $25,000 which are inadmissible assets and constitute 5 per centum of the total assets of the corporation. The invested capital of $200,000 will, therefore, have to be reduced 5 per centum, leaving an invested capital of $190,000, which amount would be used in computing the tax.

In the above example, it is assumed that no adjustments must be made on account of intangible property paid in for stock, and that no part of the State bonds may be included in invested capital because of profits from dealing in the same.

For the purpose of ascertaining the deductible percentage, the amount of inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets at the beginning of the year and the amount held at the end of the year. The total amount of admissible and inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount at the end of the year. If at any time a substantial change has taken place either in the amount of inadmissible assets or in the total amount of inadmissible and admissible assets, the effect of such change shall be averaged exactly from the date on which it occurred. In any case in which the Commissioner finds that either amount, determined as above provided, does not substantially reflect the average situation throughout the year, and that the amount of each kind of assets held on a given day of each month throughout the year or at more frequent regular intervals can be determined, the amount of inadmissible assets and the amount of both kinds of assets held during the year shall be determined by averaging the amounts held at such several times. In making these computations, the valuation at which each asset is carried shall be

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adjusted in accordance with the provisions of the statute and of the regulations relating to the valuation of assets for the purpose of computing invested capital, including in such adjustment the amount of reserves for depreciation, depletion, amortization, and other reserves which represent the valuation of assets. It is immaterial whether any asset was acquired out of invested capital or out of profits earned during the year or borrowed capital.

Computation of Average Invested Capital.—For the purpose of computing invested capital for any period of one year or less, a corporation shall add together its paid-in capital and its paid-in or earned surplus and undivided profits (under whatever name it may be called) as shown by the books at the beginning of the period. The total so obtained shall be adjusted

(a) for any property paid in or for any asset reflected in surplus and undivided profits, which is not carried on the books at the valuation prescribed by the law or regulations, and

(b) for any changes in paid-in capital or in paid-in or earned surplus and undivided profits (not including surplus and undivided profits earned during the period) occurring during the period, averaged for the time for which such changes are effective.

The total so obtained and adjusted will be the average invested capital for the period, unless the corporation at any time during the period held any inadmissible assets, in which case such total must be reduced by a percentage thereof equal to the percentage which the amount of inadmissible assets held during the period is of the total amount of admissible and inadmissible assets held during the period. Invested capital cannot be determined by adding the amounts of the assets of the corporation.

In the case of a corporation making a return for the full year of twelve months, its invested capital for the year is the average invested capital for the year.

In the case of a corporation making a return for a fractional part of a year, its invested capital for such period is the same fractional part of the average invested capital for such period. In computing the tax under a return for a fractional part of a period, the same purpose may sometimes be more readily effected by using the full average invested capital and taking a fractional part of the result. For example: A corporation was organized July 1, 1919, and makes a return for the six months ending December 31, 1919. The invested capital consists of $100,000 paid in on July 1, and $100,000 paid in on October 1. The average invested capital for

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such period would be $100,000 plus 92/184 (not 92/365) of $100,000, or $50,000, a total of $150,000. The invested capital for the period for the purpose of the tax would, however, be 6/12 of $150,000, or $75,000.

The invested capital as of the beginning of any period of one year or less should be adjusted by an appropriate addition or deduction, as the case may be, for each change in invested capital during the period. The amount so added or deducted in each case is the amount of the change averaged for the time remaining in the period during which it is in effect. The fraction used in finding such average is the number of days remaining in the period (including the day on which the change occurs) over the number of days in the period. Thus, if a return is made for the calendar year ending December 31, 1919, and if $100,000 of additional capital was paid in on February 17, 1919, this addition to invested capital is in effect for 318 days, and the amount to be added to the invested capital as of the beginning of the year would be 318/365 of $100,000, or $87,123.29. If $50,000 of this amount was withdrawn on October 31, 1919, the amount to be deducted would be 62/365 of $50,000, or $8,493.15.

Net Income Available for Dividends.—If dividends are paid from earnings of the taxable year, such payment does not affect the invested capital of the corporation. Whether at the time of any payment made during the taxable year there is sufficient income of the taxable year available for such payment, or whether the surplus or undivided profits as of the beginning of the taxable year must be reduced by the amount of such payment, shall be determined according to the following principles:

(1) The aggregate amount of earnings of the taxable year available for all purposes up to any given date will be determined upon the basis of the same proportion of the net income for the taxable year (as finally determined for the purpose of income and excess profits taxes) as the part of the year already elapsed is of the entire year, unless the corporation shows from its books or other records that a greater proportion of its earnings for the year was available on such date.

(2) The aggregate amount available will be deemed to be applied for the following purposes in the order in which they are stated:

(a) accrued Federal income and war profits and excess profits taxes for the taxable year, and

(b) dividends paid after the expiration of the first sixty days of the taxable year and other corporate purposes, including the purchase of outstanding stock of the corporation previously issued.

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In any case where the above computation would be indeterminate because of the effect of these provisions upon the invested capital for the year, the amount of such invested capital for the purpose of this computation may be deemed to be the invested capital as of the beginning of the taxable year, plus any additional capital paid in during such year and minus any specific withdrawal or liquidation of capital during such year.

Payment of Ordinary Dividends.—A dividend other than a stock dividend affects the computation of invested capital from the date when the dividend is payable and not from the date when it is declared, except that where no date is set for its payment, the date when declared will be considered also the date when payable. For the purpose of computing invested capital a dividend paid after the expiration of the first sixty days of the taxable year will be deemed to be paid out of the net income of the taxable year to the extent of the net income available for such purpose on the date when it is payable. The surplus and undivided profits as of the beginning of the taxable year will be reduced as of the date when the dividend is payable by the entire amount of any dividend paid during the first sixty days of the taxable year and by the amount of any other dividend in excess of the current net income available for its payment.

In the case of a dividend paid during the first sixty days of a taxable year which exceeds in amount the surplus and undivided profits as of the beginning of the taxable year, the excess will be deemed to be paid out of earnings of the taxable year available at the date when the dividend is payable, and to the extent that such earnings are insufficient, it will be deemed to be a liquidation of paid-in capital or surplus. From the date when any dividend is payable, the amount which the several stockholders are entitled to receive will be treated as if actually paid to them, whether or not it is so paid in fact, and the surplus and undivided profits, either of the taxable year or of the preceding years, will in accordance with the foregoing provisions be deemed to be reduced as of that date by the full amount of the dividend. Amounts paid to stockholders in anticipation of dividends, or amounts withdrawn by stockholders in excess of dividends declared, will in computing invested capital, have the same effect as if actually paid as dividends.

Payment of Stock Dividends.—The payment of a stock dividend has no effect upon the amount of invested capital. Such items as appraised value of good will, appreciation in value of real

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estate or other tangible property, etc., although carried to surplus and distributed as stock dividends, cannot in this manner be capitalized and included in computing invested capital. If a corporation has paid a stock dividend in excess of its true surplus, it cannot be deemed to have any greater invested capital than could have been computed had no such stock dividend been paid.

Surrender of Stock.—Where stock which has originally been issued or exchanged by the corporation for tangible or intangible property, is returned to it as a gift or for a consideration substantially less than its par value, the stock so returned shall not be treated as part of the stock issued or exchanged for such property. The proceeds derived in cash or its equivalent from resale of the stock thus returned shall, however, be included in computing invested capital.

Preparation of Consolidated Balance Sheet.—The invested capital of affiliated corporations required to make a consolidated return for the taxable year is the invested capital of the entire group treated as one unit operated under a common control. As a first step in the computation, a consolidated balance sheet should be prepared in accordance with standard accounting practices, which will reflect the actual assets and liabilities of the affiliated group. In preparing such a balance sheet all intercompany items, such as intercompany notes and accounts receivable and payable, should be eliminated from the assets and liabilities, respectively, and proper adjustments should be made in respect of intercompany profits or losses reflected in inventories which at the beginning or end of the taxable year contain merchandise exchanged between the corporations included in the affiliated group at prices above or below cost to the producing or original owner corporation. Such consolidated balance sheet will then show:

(a) The capital stock of the parent or principal company in the hands of the public;

(b) The consolidated surplus belonging to the stockholders of the parent or principal company; and

(c) The capital stock, if any, of subsidiary companies not owned by the parent or principal company, together with surplus, if any, belonging to such minority interest.

In computing consolidated invested capital the starting point is furnished by the total of the amounts shown under (a), (b) and (c) above. This total must be increased or diminished by any adjust-

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ments required to be made by way of additions or deductions, as heretofore explained.

Stock of Subsidiary Acquired for Cash or Stock.—When all or substantially all of the stock of a subsidiary corporation was acquired for cash, the cash so paid shall be the basis to be used in determining the value of the property acquired. If stock of a subsidiary company was acquired with the stock of the parent company, the amount to be included in the consolidated invested capital in respect of the company acquired shall be computed in the same manner as if the net tangible assets and the intangible assets had been acquired instead of the stock. If, in accordance with such acquisition a paid-in surplus is claimed, such claim shall be subject to all of the requirements necessary to establish a paid-in surplus in other cases.

Intangible Property Paid In.—In the case of corporations whose affiliation is in the nature of parent and subsidiary companies—

(a) If intangible property was bona fide, paid in for stock prior to March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per centum of the par value of the total stock or shares of the consolidation outstanding on March 3, 1917, or in the aggregate 25 per centum of the par value of the total stock or shares shown in the consolidated balance sheet at the beginning of the taxable year, whichever is lowest; and

(b) If intangible property was bona fide paid in for stock or shares on or after March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per centum of the par value of the total stock shown in the consolidated balance sheet to be outstanding at the beginning of the taxable year, whichever is lowest; and

(c) If intangible property has been acquired in part before and in part after March 3, 1917, the amounts shall be ascertained, respectively, under (a) and (b) above and in the aggregate shall in no case exceed 25 per centum of the par value of the total stock or shares outstanding at the beginning of the taxable year shown in the consolidated balance sheet.

In the case of corporations affiliated by reason of ownership by the same interests, the limitations set forth in paragraphs (4) and (5) of subdivision (a) of Section 326 of the statute shall be applied to each corporation separately and the aggregate of the intangible property, as valued, shall be included in invested capital in the con-

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solidated return. In respect of each of the affiliated corporations, the aggregate of the amounts ascertained under the provisions of paragraphs (4) and (5) of Section 326 shall in no case exceed 25 per centum of the outstanding capital stock of such corporation at the beginning of the taxable year.

Foreign Corporations.—Inasmuch as the excess profits tax in the case of a foreign corporation is not based on its invested capital, but is computed in accordance with Section 328 of the law,* the provisions of Section 326 do not apply to such corporations. Accordingly, in rendering a return of income on Form 1120, a foreign corporation should make no entry of invested capital.

Valuation of Assets upon Change of Ownership.—Where a business is reorganized, consolidated, or transferred, or property is transferred after March 3, 1917, and an interest of 50 per centum, or greater, in such business or property remains in any of the previous owners, then for the purpose of determining the invested capital each asset so transferred is valued

(a) as if still in the possession of the previous owner, if a corporation, or, if not a corporation,

(b) at its cost to such owner, with proper adjustments for losses and improvements.

RETURNS

Every corporation, domestic or foreign, which is not specifically exempt from tax is required to file a return for the purpose of the excess profits tax on Form 1120, if based on the calendar year, or Form 1120-A, if based on a fiscal year ending in 1919. Returns shall be made, and the taxes paid, at the same time and places, in the same manner, and subject to the same conditions, as is provided in the case of returns and payments of income tax by corporations, and all the provisions of Title II of the law not inapplicable, including penalties, are made applicable to excess profits taxes.

Fiscal Years Ending in 1919.—The method provided for computing the tax for a fiscal year beginning in 1918 and ending in 1919 is as follows:

(a) The tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the

* See page 179.

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number of months falling within the calendar year 1918 is of the number of months in the entire period;

(b) The tax attributable to the calendar year 1919 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1919, and determining the proportion of such tax which the number of months falling within the calendar year 1919 is of the number of months in the entire period; and

(c) The tax for the fiscal year is found by adding the tax attributable to the calendar year 1918 and the tax attributable to the calendar year 1919.

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PART V. TEXT OF REVENUE ACT OF 1918

TITLE I.—GENERAL DEFINITIONS

SECTION 1. That when used in this Act—

The term "person" includes partnerships and corporations, as well as individuals;

The term "corporation" includes associations, joint-stock companies, and insurance companies;

The term "domestic" when applied to a corporation or partnership means created or organized in the United States;

The term "foreign" when applied to a corporation or partnership means created or organized outside the United States;

The term "United States" when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia;

The term "Secretary" means the Secretary of the Treasury;

The term "Commissioner" means the Commissioner of Internal Revenue;

The term "collector" means collector of internal revenue;

The term "Revenue Act of 1916" means the Act entitled "An Act to increase the revenue, and for other purposes," approved September 8, 1916;

The term "Revenue Act of 1917" means the Act entitled "An Act to provide revenue to defray war expenses, and for other purposes," approved October 3, 1917;

The term "taxpayer" includes any person, trust or estate subject to a tax imposed by this Act;

The term "Government contract" means (a) a contract made with the United States, or with any department, bureau, officer, commission, board, or agency, under the United States and acting in its behalf, or with any agency controlled by any of the above if the contract is for the benefit of the United States, or (b) a subcontract made with a contractor performing such a contract if the products or services to be furnished under the subcontract are for the benefit of the United States.

The term "Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive" when applied to a contract of the kind referred to in clause (a) of this paragraph, includes all such contracts which, although entered into during such period, were originally not enforceable, but which have been or may become enforceable by reason of subsequent validation in pursuance of law;

The term "military or naval forces of the United States" includes the Marine Corps, the Coast Guard, the Army Nurse Corps, Female, and the Navy Nurse Corps, Female, but this shall not be deemed to exclude other units otherwise included within such term;

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The term "present war" means the war in which the United States is now engaged against the German Government.

For the purposes of this Act the date of the termination of the present war shall be fixed by proclamation of the President.

TITLE II.—INCOME TAX

PART I.—GENERAL PROVISIONS

DEFINITIONS

SEC. 200. That when used in this title—

The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or section 232. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. The first taxable year, to be called the taxable year 1918, shall be the calendar year 1918 or any fiscal year ending during the calendar year 1918;

The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person, trust or estate;

The term "withholding agent" means any person required to deduct and withhold any tax under the provisions of section 221 or section 237;

The term "personal service corporation" means a corporation whose income is to be ascribed primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation and in which capital (whether invested or borrowed) is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists either (1) of gains, profits or income derived from trading as a principal, or (2) of gains, profits, commissions or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive;

The term "paid," for the purposes of the deductions and credits under this title, means "paid or accrued" or "paid or incurred," and the terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212.

DIVIDENDS

SEC. 201.(a) That the term "dividend" when used in this title (except in paragraph (10) of subdivision (a) of section 234) means (1) any distribution made by a corporation, other than a personal service corporation, to its shareholders or members, whether in cash or in other property or in stock of the corporation, out of its earnings or profits accumulated since February 28, 1913, or (2) any such distribution made by a personal service corporation out of its earnings or profits accumulated since February 28, 1913, and prior to January 1, 1918.

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(b) Any distribution shall be deemed to have been made from earnings or profits unless all earnings and profits have first been distributed. Any distribution made in the year 1918 or any year thereafter shall be deemed to have been made from earnings or profits accumulated since February 28, 1913, or, in the case of a personal service corporation, from the most recently accumulated earnings or profits; but any earnings or profits accumulated prior to March 1, 1913, may be distributed in stock dividends or otherwise, exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed.

(c) A dividend paid in stock of the corporation shall be considered income to the amount of the earnings or profits distributed. Amounts distributed in the liquidation of a corporation shall be treated as payments in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributee as other gains or profits.

(d) If any stock dividend (1) is received by a taxpayer between January 1 and November 1, 1918, both dates inclusive, or (2) is during such period bona fide authorized or declared, and entered on the books of the corporation, and is received by a taxpayer after November 1, 1918, and before the expiration of thirty days after the passage of this Act, then such dividend shall, in the manner provided in section 206, be taxed to the recipient at the rates prescribed by law for the years in which the corporation accumulated the earnings or profits from which such dividend was paid, but the dividend shall be deemed to have been paid from the most recently accumulated earnings or profits.

(e) Any distribution made during the first sixty days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings or profits, and if the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made shall be deemed to have been accumulated ratably during such period.

BASIS FOR DETERMINING GAIN OR LOSS

SEC. 202.(a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; but when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from

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the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged.

When in the case of any such reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged.

INVENTORIES

SEC. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

NET LOSSES

SEC. 204.(a) That as used in this section the term "net loss" refers only to net losses resulting from either (1) the operation of any business regularly carried on by the taxpayer, or (2) the bona fide sale by the taxpayer of plant, buildings, machinery, equipment or other facilities, constructed, installed or acquired by the taxpayer on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war; and when so resulting means the excess of the deductions allowed by law (excluding in the case of corporations amounts allowed as a deduction under paragraph (6) of subdivision (a) of section 234) over the sum of the gross income plus any interest received free from taxation both under this title and under Title III.

(b) If for any taxable year beginning after October 31, 1918 and ending prior to January 1, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount of such net loss shall under regulations prescribed by the Commissioner with the approval of the Secretary be deducted from the net income of the taxpayer for the preceding taxable year; and the taxes imposed by this title and by Title III for such preceding taxable year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. If such net loss is in excess of the net income for such preceding taxable year, the amount of such excess shall under regulations prescribed by the Commissioner with the approval of the Secretary be allowed as a deduction in computing the net income for the succeeding taxable year.

(c) The benefit of this section shall be allowed to the members of a partnership and the beneficiaries of an estate or trust under regulations prescribed by the Commissioner with the approval of the Secretary

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FISCAL YEAR WITH DIFFERENT RATES

SEC. 205.(a) That if a taxpayer makes return for a fiscal year beginning in 1917 and ending in 1918, his tax under this title for the first taxable year shall be the sum of: (1) the same proportion of a tax for the entire period computed under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 and under Title I of the Revenue Act of 1917, which the portion of such period falling within the calendar year 1917 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rates for the calendar year 1918 which the portion of such period falling within the calendar year 1918 is of the entire period: *Provided*, That in the case of a personal service corporation the amount to be paid shall be only that specified in clause (1).

Any amount heretofore or hereafter paid on account of the tax imposed for such fiscal year by Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917, and by Title I of the Revenue Act of 1917, shall be credited towards the payment of the tax imposed for such fiscal year by this act, and if the amount so paid exceeds the amount of such tax imposed by this act, or, in the case of a personal service corporation, the amount specified in clause (1), the excess shall be credited or refunded in accordance with the provisions of section 252.

(b) If a taxpayer makes a return for a fiscal year beginning in 1918 and ending in 1919, the tax under this title for such fiscal year shall be the sum of: (1) the same proportion of a tax for the entire period computed under this title at the rates specified for the calendar year 1918 which the portion of such period falling within the calendar year 1918 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rates specified for the calendar year 1919 which the portion of such period falling within the calendar year 1919 is of the entire period.

(c) If a fiscal year of a partnership begins in 1917 and ends in 1918 or begins in 1918 and ends in 1919, then notwithstanding the provisions of subdivision (b) of section 218, (1) the rates for the calendar year during which such fiscal year begins shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year: *Provided*, That in the case of a personal service corporation with respect to a fiscal year beginning in 1917 and ending in 1918, the amount specified in clause (1) shall not be subject to normal tax.

PARTS OF INCOME SUBJECT TO RATES FOR DIFFERENT YEARS

SEC. 206. That whenever parts of a taxpayer's income are subject to rates for different calendar years, the part subject to the rates for the most recent calendar year shall be placed in the lower brackets of

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the rate schedule provided in this title, the part subject to the rates for the next preceding calendar year shall be placed in the next higher brackets of the rate schedule applicable to that year, and so on until the entire net income has been accounted for. In determining the income, any deductions, exemptions or credits of a kind not plainly and properly chargeable against the income taxable at rates for a preceding year shall first be applied against the income subject to rates for the most recent calendar year; but any balance thereof shall be applied against the income subject to the rates of the next preceding year or years until fully allowed.

PART II.—INDIVIDUALS

NORMAL TAX

SEC. 210. That, in lieu of the taxes imposed by subdivision (a) of section 1 of the Revenue Act of 1916 and by section 1 of the Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax at the following rates:

(a) For the calendar year 1918, 12 per centum of the amount of the net income in excess of the credits provided in section 216: *Provided*, That in the case of a citizen or resident of the United States the rate upon the first $4,000 of such excess amount shall be 6 per centum;

(b) For each calendar year thereafter, 8 per centum of the amount of the net income in excess of the credits provided in section 216: *Provided*, That in the case of a citizen or resident of the United States the rate upon the first $4,000 of such excess amount shall be 4 per centum.

SURTAX

SEC. 211.(a) That, in lieu of the taxes imposed by subdivision (b) of section 1 of the Revenue Act of 1916 and by section 2 of the Revenue Act of 1917, but in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual, a surtax equal to the sum of the following:

1 per centum of the amount by which the net income exceeds $5,000 and does not exceed $6,000;

2 per centum of the amount by which the net income exceeds $6,000 and does not exceed $8,000;

3 per centum of the amount by which the net income exceeds $8,000 and does not exceed $10,000;

4 per centum of the amount by which the net income exceeds $10,000 and does not exceed $12,000;

5 per centum of the amount by which the net income exceeds $12,000 and does not exceed $14,000;

6 per centum of the amount by which the net income exceeds $14,000 and does not exceed $16,000;

7 per centum of the amount by which the net income exceeds $16,000 and does not exceed $18,000;

8 per centum of the amount by which the net income exceeds $18,000 and does not exceed $20,000;

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9 per centum of the amount by which the net income exceeds $20,000 and does not exceed $22,000;
10 per centum of the amount by which the net income exceeds $22,000 and does not exceed $24,000;
11 per centum of the amount by which the net income exceeds $24,000 and does not exceed $26,000;
12 per centum of the amount by which the net income exceeds $26,000 and does not exceed $28,000;
13 per centum of the amount by which the net income exceeds $28,000 and does not exceed $30,000;
14 per centum of the amount by which the net income exceeds $30,000 and does not exceed $32,000;
15 per centum of the amount by which the net income exceeds $32,000 and does not exceed $34,000;
16 per centum of the amount by which the net income exceeds $34,000 and does not exceed $36,000;
17 per centum of the amount by which the net income exceeds $36,000 and does not exceed $38,000;
18 per centum of the amount by which the net income exceeds $38,000 and does not exceed $40,000;
19 per centum of the amount by which the net income exceeds $40,000 and does not exceed $42,000;
20 per centum of the amount by which the net income exceeds $42,000 and does not exceed $44,000;
21 per centum of the amount by which the net income exceeds $44,000 and does not exceed $46,000;
22 per centum of the amount by which the net income exceeds $46,000 and does not exceed $48,000;
23 per centum of the amount by which the net income exceeds $48,000 and does not exceed $50,000;
24 per centum of the amount by which the net income exceeds $50,000 and does not exceed $52,000;
25 per centum of the amount by which the net income exceeds $52,000 and does not exceed $54,000;
26 per centum of the amount by which the net income exceeds $54,000 and does not exceed $56,000;
27 per centum of the amount by which the net income exceeds $56,000 and does not exceed $58,000;
28 per centum of the amount by which the net income exceeds $58,000 and does not exceed $60,000;
29 per centum of the amount by which the net income exceeds $60,000 and does not exceed $62,000;
30 per centum of the amount by which the net income exceeds $62,000 and does not exceed $64,000;
31 per centum of the amount by which the net income exceeds $64,000 and does not exceed $66,000;
32 per centum of the amount by which the net income exceeds $66,000 and does not exceed $68,000;
33 per centum of the amount by which the net income exceeds $68,000 and does not exceed $70,000;
34 per centum of the amount by which the net income exceeds $70,000 and does not exceed $72,000;

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35 per centum of the amount by which the net income exceeds $72,000 and does not exceed $74,000;
36 per centum of the amount by which the net income exceeds $74,000 and does not exceed $76,000;
37 per centum of the amount by which the net income exceeds $76,000 and does not exceed $78,000;
38 per centum of the amount by which the net income exceeds $78,000 and does not exceed $80,000;
39 per centum of the amount by which the net income exceeds $80,000 and does not exceed $82,000;
40 per centum of the amount by which the net income exceeds $82,000 and does not exceed $84,000;
41 per centum of the amount by which the net income exceeds $84,000 and does not exceed $86,000;
42 per centum of the amount by which the net income exceeds $86,000 and does not exceed $88,000;
43 per centum of the amount by which the net income exceeds $88,000 and does not exceed $90,000;
44 per centum of the amount by which the net income exceeds $90,000 and does not exceed $92,000;
45 per centum of the amount by which the net income exceeds $92,000 and does not exceed $94,000;
46 per centum of the amount by which the net income exceeds $94,000 and does not exceed $96,000;
47 per centum of the amount by which the net income exceeds $96,000 and does not exceed $98,000;
48 per centum of the amount by which the net income exceeds $98,000 and does not exceed $100,000;
52 per centum of the amount by which the net income exceeds $100,000 and does not exceed $150,000;
56 per centum of the amount by which the net income exceeds $150,000 and does not exceed $200,000;
60 per centum of the amount by which the net income exceeds $200,000 and does not exceed $300,000;
63 per centum of the amount by which the net income exceeds $300,000 and does not exceed $500,000;
64 per centum of the amount by which the net income exceeds $500,000 and does not exceed $1,000,000;
65 per centum of the amount by which the net income exceeds $1,000,000.

(b) In the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this section attributable to such sale shall not exceed 20 per centum of the selling price of such property or interest.

NET INCOME DEFINED

SEC. 212.(a) That in the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by section 214.

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(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

If a taxpayer changes his accounting period from fiscal year to calendar year, or from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with approval of the Commissioner, be computed on the basis of such new accounting period, subject to the provisions of section 226.

GROSS INCOME DEFINED

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but

(b) Does not include the following items, which shall be exempt from taxation under this title:

(1) The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured;

(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income);

(4) Interest upon (a) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) securities issued under the provisions of the Federal Farm Loan Act of July

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17, 1916; or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation: *Provided*, That every person owning any of the obligations, securities or bonds enumerated in clauses (a), (b), (c), and (d) shall, in the return required by this title, submit a statement showing the number and amount of such obligations, securities and bonds owned by him and the income received therefrom, in such form and with such information as the Commissioner may require. In the case of obligations of the United States issued after September 1, 1917, and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt from taxation to the taxpayer both under this title and under Title III;

(5) The income of foreign governments received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments, or from interest on deposits in banks in the United States of moneys belonging to such foreign governments, or from any other source within the United States;

(6) Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness;

(7) Income derived from any public utility or the exercise of any essential governmental function and accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, or income accruing to the government of any possession of the United States, or any political subdivision thereof.

Whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, prior to September 8, 1916, entered in good faith into a contract with any person, the object and purpose of which is to acquire, construct, operate, or maintain a public utility, no tax shall be levied under the provisions of this title upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, District of Columbia, or political subdivision; but this provision is not intended to confer upon such person any financial gain or exemption or to relieve such person from the payment of a tax as provided for in this title upon the part or portion of such income to which such person is entitled under such contract;

(8) So much of the amount received during the present war by a person in the military or naval forces of the United States as salary or compensation in any form from the United States for active services in such forces, as does not exceed $3,500.

(c) In the case of nonresident alien individuals, gross income includes only the gross income from sources within the United States, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, dividends from resident corporations, and including all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture and disposition of goods within the United States.

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DEDUCTIONS ALLOWED

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity;

(2) All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917), the interest upon which is wholly exempt from taxation under this title as income to the taxpayer, or, in the case of a nonresident alien individual, the proportion of such interest which the amount of his gross income from sources within the United States bears to the amount of his gross income from all sources within and without the United States;

(3) Taxes paid or accrued within the taxable year imposed (a) by the authority of the United States, except income, war-profits and excess-profits taxes; or (b) by the authority of any of its possessions, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 222; or (c) by the authority of any State or Territory, or any county, school district, municipality, or other taxing subdivision of any State or Territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed; or (d) in the case of a citizen or resident of the United States, by the authority of any foreign country, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 222; or (e) in the case of a nonresident alien individual, by the authority of any foreign country (except income, war-profits and excess-profits taxes, and taxes assessed against local benefits of a kind tending to increase the value of the property assessed), upon property or business;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a nonresident alien individual only as to such transactions within the United States;

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a nonresident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise;

(7) Debts ascertained to be worthless and charged off within the taxable year;

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

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(9) In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war, there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous Acts of Congress as a deduction in computing net income. At any time within three years after the termination of the present war, the Commissioner may, and at the request of the taxpayer shall, reexamine the return, and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the taxes imposed by this title and by Title III for the year or years affected shall be redetermined; and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252;

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

(11) Contributions or gifts made within the taxable year to corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to the special fund for vocational rehabilitation authorized by section 7 of the Vocational Rehabilitation Act, to an amount not in excess of 15 per centum of the taxpayer's net income as computed without the benefit of this paragraph. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary. In the case of a nonresident alien individual this deduction shall be allowed only as to contributions or gifts made to domestic corporations, or to such vocational rehabilitation fund;

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(12) (a) At the time of filing return for the taxable year 1918 a taxpayer may file a claim in abatement based on the fact that he has sustained a substantial loss (whether or not actually realised by sale or other disposition) resulting from any material reduction (not due to temporary fluctuation) of the value of the inventory for such taxable year, or from the actual payment after the close of such taxable year of rebates in pursuance of contracts entered into during such year upon sales made during such year. In such case payment of the amount of the tax covered by such claim shall not be required until the claim is decided, but the taxpayer shall accompany his claim with a bond in double the amount of the tax covered by the claim, with sureties satisfactory to the Commissioner, conditioned for the payment of any part of such tax found to be due, with interest. If any part of such claim is disallowed then the remainder of the tax due shall on notice and demand by the collector be paid by the taxpayer with interest at the rate of 1 per centum per month from the time the tax would have been due had no such claim been filed. If it is shown to the satisfaction of the Commissioner that such substantial loss has been sustained, then in computing the tax imposed by this title the amount of such loss shall be deducted from the net income. (b) If no such claim is filed, but it is shown to the satisfaction of the Commissioner that during the taxable year 1919 the taxpayer has sustained a substantial loss of the character above described then the amount of such loss shall be deducted from the net income for the taxable year 1918 and the tax imposed by this title for such year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252.

(b) In the case of a nonresident alien individual the deductions allowed in paragraphs (1), (4), (7), (8), (9), (10), (12), and clause (c) of paragraph (3), of subdivision (a) shall be allowed only if and to the extent that they are connected with income arising from a source within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

ITEMS NOT DEDUCTIBLE

SEC. 215. That in computing net income no deduction shall in any case be allowed in respect of—

(a) Personal, living, or family expenses;

(b) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

(c) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made; or

(d) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

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CREDITS ALLOWED

SEC. 216. That for the purpose of the normal tax only there shall be allowed the following credits:

(a) The amount received as dividends from a corporation which is taxable under this title upon its net income, and amounts received as dividends from a personal service corporation out of earnings or profits upon which income tax has been imposed by Act of Congress;

(b) The amount received as interest upon obligations of the United States and bonds issued by the War Finance Corporation, which is included in gross income under section 213;

(c) In the case of a single person, a personal exemption of $1,000, or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $2,000. A husband and wife living together shall receive but one personal exemption of $2,000 against their aggregate net income; and in case they make separate returns, the personal exemption of $2,000 may be taken by either or divided between them;

(d) $200 for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer, if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective;

(e) In the case of a nonresident alien individual who is a citizen or subject of a country which imposes an income tax, the credits allowed in subdivisions (c) and (d) shall be allowed only if such country allows a similar credit to citizens of the United States not residing in such country.

NONRESIDENT ALIENS—ALLOWANCE OF DEDUCTIONS AND CREDITS

SEC. 217. That a nonresident alien individual shall receive the benefit of the deductions and credits allowed in this title only by filing or causing to be filed with the collector a true and accurate return of his total income received from all sources corporate or otherwise in the United States, in the manner prescribed by this title, including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits: *Provided*, That the benefit of the credits allowed in subdivisions (c) and (d) of section 216 may, in the discretion of the Commissioner, and except as otherwise provided in subdivision (e) of that section, be received by filing a claim therefor with the withholding agent. In case of failure to file a return, the collector shall collect the tax on such income, and all property belonging to such nonresident alien individual shall be liable to distraint for the tax.

PARTNERSHIPS AND PERSONAL SERVICE CORPORATIONS

SEC. 218.(a) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon

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the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.

The partner shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the partnership.

(b) If a fiscal year of a partnership ends during a calendar year for which the rates of tax differ from those for the preceding calendar year, then (1) the rates for such preceding calendar year shall apply to an amount of each partner's share of such partnership net income equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to the remainder.

(c) In the case of an individual member of a partnership which makes return for a fiscal year beginning in 1917 and ending in 1918, his proportionate share of any excess profits tax imposed upon the partnership under the Revenue Act of 1917 with respect to that part of such fiscal year falling in 1917, shall, for the purpose of determining the tax imposed by this title, be credited against that portion of the net income embraced in his personal return for the taxable year 1918 to which the rates for 1917 apply.

(d) The net income of the partnership shall be computed in the same manner and on the same basis as provided in section 212 except that the deduction provided in paragraph (11) of subdivision (a) of section 214 shall not be allowed.

(e) Personal service corporations shall not be subject to taxation under this title, but the individual stockholders thereof shall be taxed in the same manner as the members of partnerships. All the provisions of this title relating to partnerships and the members thereof shall so far as practicable apply to personal service corporations and the stockholders thereof: *Provided*, That for the purpose of this subdivision amounts distributed by a personal service corporation during its taxable year shall be accounted for by the distributees; and any portion of the net income remaining undistributed at the close of its taxable year shall be accounted for by the stockholders of such corporation at the close of its taxable year in proportion to their respective shares.

ESTATES AND TRUSTS

SEC. 219.(a) That the tax imposed by section 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;

(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(3) Income held for future distribution under the terms of the will or trust; and

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(4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that there shall also be allowed as a deduction (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, or any corporation organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual; and in cases under paragraph (4) of subdivision (a) of this section the fiduciary shall include in the return a statement of each beneficiary's distributive share of such net income, whether or not distributed before the close of the taxable year for which the return is made.

(c) In cases under paragraph (1), (2), or (3) of subdivision (a) the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir or other beneficiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary his distributive share, whether distributed or not, of the net income of the estate or trust for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the estate or trust is computed, then his distributive share of the net income of the estate or trust for any accounting period of such estate or trust ending within the fiscal or calendar year upon the basis of which such beneficiary's net income is computed. In such cases the beneficiary shall, for the purpose of the normal tax, be allowed as credits in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust.

PROFITS OF CORPORATIONS TAXABLE TO STOCKHOLDERS

SEC. 220. That if any corporation, however created or organised, is formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders or members through the medium of

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permitting its gains and profits to accumulate instead of being divided or distributed, such corporation shall not be subject to the tax imposed by section 230, but the stockholders or members thereof shall be subject to taxation under this title in the same manner as provided in subdivision (e) of section 218 in the case of stockholders of a personal service corporation, except that the tax imposed by Title III shall be deducted from the net income of the corporation before the computation of the proportionate share of each stockholder or member. The fact that any corporation is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a purpose to escape the surtax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the tax in such case unless the Commissioner certifies that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner, or any collector, every corporation shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed, and of the amounts that would be payable to each.

PAYMENT OF TAX AT SOURCE

SEC. 221.(a) That all individuals, corporations and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, of any nonresident alien individual (other than income received as dividends from a corporation which is taxable under this title upon its net income) shall (except in the cases provided for in subdivision (b) and except as otherwise provided in regulations prescribed by the Commissioner under section 217) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 8 per centum thereof: *Provided*, That the Commissioner may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent.

(b) In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation contain a contract or provisions by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods and whether payable to a nonresident alien individual or to an individual citizen or resident of the United States or to a partnership: *Provided*, That the Commissioner may authorize such tax to be deducted and withheld in the case

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of interest upon any such bonds, mortgages, deeds of trust or other obligations, the owners of which are not known to the withholding agent. Such deduction and withholding shall not be required in the case of a citizen or resident entitled to receive such interest, if he files with the withholding agent on or before February 1, a signed notice in writing claiming the benefit of the credits provided in subdivisions (c) and (d) of section 216; nor in the case of a nonresident alien individual if so provided for in regulations prescribed by the Commissioner under section 217.

(c) Every individual, corporation, or partnership required to deduct and withhold any tax under this section shall make return thereof on or before March first of each year and shall on or before June fifteenth pay the tax to the official of the United States Government authorized to receive it. Every such individual, corporation, or partnership is hereby made liable for such tax and is hereby indemnified against the claims and demands of any individual, corporation, or partnership for the amount of any payments made in accordance with the provisions of this section.

(d) Income upon which any tax is required to be withheld at the source under this section shall be included in the return of the recipient of such income, but any amount of tax so withheld shall be credited against the amount of income tax as computed in such return.

(e) If any tax required under this section to be deducted and withheld is paid by the recipient of the income, it shall not be re-collected from the withholding agent; nor in cases in which the tax is so paid shall any penalty be imposed upon or collected from the recipient of the income or the withholding agent for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

CREDIT FOR TAXES

SEC. 222.(a) That the tax computed under Part II of this title shall be credited with:

(1) In the case of a citizen of the United States, the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States; and

(2) In the case of a resident of the United States, the amount of any such taxes paid during the taxable year to any possession of the United States; and

(3) In the case of an alien resident of the United States who is a citizen or subject of a foreign country, the amount of any such taxes paid during the taxable year to such country, upon income derived from sources therein, if such country, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; and

(4) In the case of any such individual who is a member of a partnership or a beneficiary of an estate or trust, his proportionate share of such taxes of the partnership or the estate or trust paid during the taxable year to a foreign country or to any possession of the United States, as the case may be

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(b) If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Commissioner who shall redetermine the amount of the tax due under Part II of this title for the year or years affected, and the amount of tax due upon such redetermination, if any, shall be paid by the taxpayer upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the taxpayer to give a bond with sureties satisfactory to and to be approved by the Commissioner in such penal sum as the Commissioner may require, conditioned for the payment by the taxpayer of any amount of tax found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(c) These credits shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income derived from sources within such foreign country or such possession of the United States, and all other information necessary for the computation of such credits.

INDIVIDUAL RETURNS

SEC. 223. That every individual having a net income for the taxable year of $1,000 or over if single or if married and not living with husband or wife, or of $2,000 or over if married and living with husband or wife, shall make under oath a return stating specifically the items of his gross income and the deductions and credits allowed by this title. If a husband and wife living together have an aggregate net income of $2,000 or over, each shall make such a return unless the income of each is included in a single joint return.

If the taxpayer is unable to make his own return, the return shall be made by a duly authorized agent or by the guardian or other person charged with the care of the person or property of such taxpayer.

PARTNERSHIP RETURNS

SEC. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

FIDUCIARY RETURNS

SEC. 225. That every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for the individual, estate or trust for which he acts (1) if the net income of such individual is $1,000 or over if single or if married and not living with husband or wife, or $2,000 or over if married and living with husband or wife, or (2) if the

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net income of such estate or trust is $1,000 or over or if any beneficiary of such estate or trust is a nonresident alien, stating specifically the items of the gross income and the deductions and credits allowed by this title. Under such regulations as the Commissioner with the approval of the Secretary may prescribe, a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of such individual, estate or trust to enable him to make the return, and that the same is, to the best of his knowledge and belief, true and correct.

Fiduciaries required to make returns under this Act shall be subject to all the provisions of this Act which apply to individuals.

RETURNS WHEN ACCOUNTING PERIOD CHANGED

SEC. 226. That if a taxpayer, with the approval of the Commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year. If a taxpayer making his first return for income tax keeps his accounts on the basis of a fiscal year he shall make a separate return for the period between the beginning of the calendar year in which such fiscal year ends and the end of such fiscal year.

In all of the above cases the net income shall be computed on the basis of such period for which separate return is made, and the tax shall be paid thereon at the rate for the calendar year in which such period is included; and the credits provided in subdivisions (c) and (d) of section 216 shall be reduced respectively to amounts which bear the same ratio to the full credits provided in such subdivisions as the number of months in such period bears to twelve months.

TIME AND PLACE FOR FILING RETURNS

(SEC. 227.(a) That returns shall be made on or before the fifteenth day of the third month following the close of the fiscal year, or if the return is made on the basis of the calendar year, then the return, shall be made on or before the fifteenth day of March. The Commissioner may grant a reasonable extension of time for filing returns whenever in his judgment good cause exists and shall keep a record of every such extension and the reason therefor. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

(b) Returns shall be made to the collector for the district in which is located the legal residence or principal place of business of the person making the return, or, if he has no legal residence or principal place of business in the United States, then to the collector at Baltimore, Maryland.

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UNDERSTATEMENT IN RETURNS

SEC. 228. That if the collector or deputy collector has reason to believe that the amount of any income return is understated, he shall give due notice to the taxpayer making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated, may increase the same accordingly. Such taxpayer may furnish sworn testimony to prove any relevant facts and if dissatisfied with the decision of the collector may appeal to the Commissioner for his decision, under such rules of procedure as may be prescribed by the Commissioner with the approval of the Secretary.

PART III.—CORPORATIONS

TAX ON CORPORATIONS

SEC. 230.(a) That, in lieu of the taxes imposed by section 10 of the Revenue Act of 1916, as amended by the Revenue Act of 1917, and by section 4 of the Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates:

(1) For the calendar year 1918, 12 per centum of the amount of the net income in excess of the credits provided in section 236; and

(2) For each calendar year thereafter, 10 per centum of such excess amount.

(b) For the purposes of the Act approved March 21, 1918, entitled "An Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes," five-sixths of the tax imposed by paragraph (1) of subdivision (a) and four-fifths of the tax imposed by paragraph (2) of subdivision (a) shall be treated as levied by an Act in amendment of Title I of the Revenue Act of 1917.

CONDITIONAL AND OTHER EXEMPTIONS

SEC. 231. That the following organizations shall be exempt from taxation under this title—

(1) Labor, agricultural, or horticultural organizations;

(2) Mutual savings banks not having a capital stock represented by shares;

(3) Fraternal beneficiary societies, orders, or associations, (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and (b) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

(4) Domestic building and loan associations and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

(5) Cemetery companies owned and operated exclusively for the benefit of their members;

(6) Corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual.

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(7) Business leagues, chambers of commerce, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or individual;

(8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare;

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private stockholder or member;

(10) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses;

(11) Farmers', fruit growers', or like associations, organized and operated as sales agents for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

(12) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title;

(13) Federal land banks and national farm-loan associations as provided in section 26 of the act approved July 17, 1916, entitled "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes";

(14) Personal service corporations.

NET INCOME DEFINED

SEC. 232. That in the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by section 234, and the net income shall be computed on the same basis as is provided in subdivision (b) of section 212 or in section 226.

GROSS INCOME DEFINED

SEC. 233.(a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213, except that:

(1) In the case of life insurance companies there shall not be included in gross income such portion of any actual premium received from any individual policyholder as is paid back or credited to or treated as an abatement of premium of such policyholder within the taxable year.

(2) Mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.

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(b) In the case of a foreign corporation gross income includes only the gross income from sources within the United States, including the interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, dividends from resident corporations, and including all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture and disposition of goods within the United States.

DEDUCTIONS ALLOWED

SEC. 234.(a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917) the interest upon which is wholly exempt from taxation under this title as income to the taxpayer, or, in the case of a foreign corporation, the proportion of such interest which the amount of its gross income from sources within the United States bears to the amount of its gross income from all sources within and without the United States;

(3) Taxes paid or accrued within the taxable year imposed (a) by the authority of the United States, except income, war-profits and excess-profits taxes; or (b) by the authority of any of its possessions, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 238; or (c) by the authority of any State or Territory, or any county, school district, municipality, or other taxing subdivision of any State or Territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed; or (d) in the case of a domestic corporation, by the authority of any foreign country, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 238; or (e) in the case of a foreign corporation, by the authority of any foreign country (except income, war-profits and excess-profits taxes, and taxes assessed against local benefits of a kind tending to increase the value of the property assessed), upon the property or business: *Provided*, That in the case of obligors specified in subdivision (b) of section 221 no deduction for the payment of the tax imposed by this title or any other tax paid pursuant to the contract or provision referred to in that subdivision, shall be allowed;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

(5) Debts ascertained to be worthless and charged off within the taxable year;

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(6) Amounts received as dividends from a corporation which is taxable under this title upon its net income, and amounts received as dividends from a personal service corporation out of earnings or profits upon which income tax has been imposed by Act of Congress;

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

(8) In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war, there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous acts of Congress as a deduction in computing net income. At any time within three years after the termination of the present war the Commissioner may, and at the request of the taxpayer shall, reexamine the return, and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the taxes imposed by this title and by Title III for the year or years affected shall be redetermined and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252;

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

(10) In the case of insurance companies, in addition to the above: (a) The net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and (b) the sums other than dividends paid within the taxable year on policy and annuity contracts;

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(11) In the case of corporations issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan continuing for life and not subject to cancellation, in addition to the above, such portion of the net addition (not required by law) made within the taxable year to reserve funds as the Commissioner finds to be required for the protection of the holders of such policies only;

(12) In the case of mutual marine insurance companies, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (10), inclusive, amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(13) In the case of mutual insurance companies (other than mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (10), inclusive, (unless otherwise allowed under such paragraphs) the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves;

(14) (a) At the time of filing return for the taxable year 1918 a taxpayer may file a claim in abatement based on the fact that he has sustained a substantial loss (whether or not actually realized by sale or ther disposition) resulting from any material reduction (not due to temporary fluctuation) of the value of the inventory for such taxable year, or from the actual payment after the close of such taxable year of rebates in pursuance of contracts entered into during such year upon sales made during such year. In such case payment of the amount of the tax covered by such claim shall not be required until the claim is decided, but the taxpayer shall accompany his claim with a bond in double the amount of the tax covered by the claim, with sureties satisfactory to the Commissioner, conditioned for the payment of any part of such tax found to be due, with interest. If any part of such claim is disallowed then the remainder of the tax due shall on notice and demand by the collector be paid by the taxpayer with interest at the rate of 1 per centum per month from the time the tax would have been due had no such claim been filed. If it is shown to the satisfaction of the Commissioner that such substantial loss has been sustained, then in computing the taxes imposed by this title and by Title III the amount of such loss shall be deducted from the net income. (b) If no such claim is filed, but it is shown to the satisfaction of the Commissioner that during the taxable year 1919 the taxpayer has sustained a substantial loss of the character above described then the amount of such loss shall be deducted from the net income for the taxable year 1918 and the taxes imposed by this title and by Title III for such year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252.

(b) In the case of a foreign corporation the deductions allowed in subdivision (a), except those allowed in paragraph (2) and in clauses (a), (b), and (c) of paragraph (3), shall be allowed only if and to the extent

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that they are connected with income arising from a source within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

ITEMS NOT DEDUCTIBLE

SEC. 235. That in computing net income no deduction shall in any case be allowed in respect of any of the items specified in section 215.

CREDITS ALLOWED

SEC. 236. That for the purpose only of the tax imposed by section 230 there shall be allowed the following credits:

(a) The amount received as interest upon obligations of the United States and bonds issued by the War Finance Corporation, which is included in gross income under section 233;

(b) The amount of any taxes imposed by Title III for the same taxable year: *Provided*, That in the case of a corporation which makes return for a fiscal year beginning in 1917 and ending in 1918, in computing the tax as provided in subdivision (a) of section 205, the tax computed for the entire period under Title II of the Revenue Act of 1917 shall be credited against the net income computed for the entire period under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 and under Title I of the Revenue Act of 1917, and the tax computed for the entire period under Title III of this Act at the rates prescribed for the calendar year 1918 shall be credited against the net income computed for the entire period under this title; and

(c) In the case of a domestic corporation, $2,000.

PAYMENT OF TAX AT SOURCE

SEC. 237. That in the case of foreign corporations subject to taxation under this title not engaged in trade or business within the United States and not having any office or place of business therein, there shall be deducted any withheld at the source in the same manner and upon the same items of income as is provided in section 221 a tax equal to 10 per centum thereof, and such tax shall be returned and paid in the same manner and subject to the same conditions as provided in that section: *Provided*, That in the case of interest described in subdivision (b) of that section the deduction and withholding shall be at the rate of 2 per centum.

CREDIT FOR TAXES

SEC. 238.(a) That in the case of a domestic corporation the total taxes imposed for the taxable year by this title and by Title III shall be credited with the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States.

If accrued taxes when paid differ from the amounts claimed as credits by the corporation, or if any tax paid is refunded in whole or in part, the corporation shall at once notify the Commissioner who shall redetermine the amount of the taxes due under this title and under Title III for the year or years affected, and the amount of taxes due upon such redeter-

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mination, if any, shall be paid by the corporation upon notice and demand by the collector, or the amount of taxes overpaid, if any, shall be credited or refunded to the corporation in accordance with the provisions of section 252. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the corporation to give a bond with sureties satisfactory to and to be approved by him in such penal sum as he may require, conditioned for the payment by the taxpayer of any amount of taxes found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(b) This credit shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income derived from sources within foreign country or such possession of the United States, as the case may be, and all other information necessary for the computation of such credit.

(c) If a domestic corporation makes a return for a fiscal year beginning in 1917 and ending in 1918, only that proportion of this credit shall be allowed which the part of such period within the calendar year 1918 bears to the entire period.

CORPORATION RETURNS

SEC. 239. That every corporation subject to taxation under this title and every personal service corporation shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice-president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agnet. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

Returns made under this section shall be subject to the provisions of sections 226 and 228.

When return is made under section 226 the credit provided in subdivision (c) of section 236 shall be reduced to an amount which bears the same ratio to the full credit therein provided as the number of months in the period for which such return is made bears to twelve months.

CONSOLIDATED RETURNS

SEC. 240.(a) That corporations which are affiliated within the meaning of this section shall, under regulations to be prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income and invested capital for the purposes of this title and Title III, and the taxes thereunder shall be computed and determined upon

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the basis of such return: *Provided*, That there shall be taken out of such consolidated net income and invested capital, the net income and invested capital of any such affiliated corporation organized after August 1, 1914, and not successor to a then existing business, 50 per centum or more of whose gross income consists of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive. In such case the corporation so taken out shall be separately assessed on the basis of its own invested capital and net income and the remainder of such affiliated group shall be assessed on the basis of the remaining consolidated invested capital and net income.

In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit of $2,000 (as provided in section 236); in computing the war-profits credit (as provided in section 311) only one specific exemption of $3,000; and in computing the excess-profits credit (as provided in section 312) only one specific exemption of $3,000.

(b) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (2) if substantially all the stock of two or more corporations is owned or controlled by the same interests.

(c) For the purposes of section 238 a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be deemed to have paid the same proportion of any income, war-profits, and excess-profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources without the United States, which the amount of any dividends (not deductible under section 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid: *Provided*, That in no such case shall the amount of the credit for such taxes exceed the amount of such dividends (not deductible under section 234) received by such domestic corporation during the taxable year.

TIME AND PLACE FOR FILING RETURNS

SEC. 241.(a) That returns of corporations shall be made at the same time as is provided in subdivision (a) of section 227.

(b) Returns shall be made to the collector of the district in which is located the principal place of business or principal office or agency of the corporation, or, if it has no principal place of business or principal office or agency in the United States, then to the collector at Baltimore, Maryland.

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PART IV.—ADMINISTRATIVE PROVISIONS

PAYMENT OF TAXES

SEC. 250.(a) That except as otherwise provided in this section and sections 221 and 237 the tax shall be paid in four installments, each consisting of one-fourth of the total amount of the tax. The first installment shall be paid at the time fixed by law for filing the return, and the second installment shall be paid on the fifteenth day of the third month, the third installment on the fifteenth day of the six month, and the fourth installment on the fifteenth day of the ninth month, after the time fixed by law for filing the return. Where an extension of time for filing a return is granted the time for payment of the first installment shall be postponed until the date of the expiration of the period of the extension, but the time for payment of the other installments shall not be postponed unless the Commissioner so provides in granting the extension. In any case in which the time for the payment of any installment is at the request of the taxpayer thus postponed, there shall be added as part of such installment interest thereon at the rate of ½ of 1 per centum per month from the time it would have been due if no extension had been granted, until paid. If any installment is not paid when due, the whole amount of the tax unpaid shall become due and payable upon notice and demand by the collector.

The tax may at the option of the taxpayer be paid in a single payment instead of in installments, in which case the total amount shall be paid on or before the time fixed by law for filing the return, or, where an extension of time for filing the return has been granted, on or before the expiration of the period of such extension.

(b) As soon as practicable after the return is filed, the Commissioner shall examine it. If it then appears that the correct amount of the tax is greater or less than that shown in the return, the installments shall be recomputed. If the amount already paid exceeds that which should have been paid on the basis of the installments as recomputed, the excess so paid shall be credited against the subsequent installments; and if the amount already paid exceeds the correct amount of the tax, the excess shall be credited or refunded to the taxpayer in accordance with the provisions of section 252.

If the amount already paid is less than that which should have been paid, the difference shall, to the extent not covered by any credits then due to the taxpayer under section 252, be paid upon notice and demand by the collector. In such case if the return is made in good faith and the understatement of the amount in the return is not due to any fault of the taxpayer, there shall be no penalty because of such understatement. If the understatement is due to negligence on the part of the taxpayer, but without intent to defraud, there shall be added as part of the tax 5 per centum of the total amount of the deficiency plus interest at the rate of 1 per centum per month on the amount of the deficiency of each installment from the time the installment was due.

If the understatement is false or fraudulent with intent to evade the tax, then, in lieu of the penalty provided by section 3176 of the Revised Statutes, as amended, for false or fraudulent returns wilfully made, but in addition to other penalties provided by law for false or fraudulent

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returns, there shall be added as part of the tax 50 per centum of the amount of the deficiency.

(c) If the return is made pursuant to section 3176 of the Revised Statutes as amended, the amount of tax determined to be due under such return shall be paid upon notice and demand by the collector.

(d) Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. In the case of such false or fraudulent returns, the amount of tax due may be determined at any time after the return is filed, and the tax may be collected at any time after it becomes due.

(e) If any tax remains unpaid after the date when it is due, and for ten days after notice and demand by the collector, then, except in the case of estates of insane, deceased, or insolvent persons, there shall be added as part of the tax the sum of 5 per centum on the amount due but unpaid, plus interest at the rate of 1 per centum per month upon such amount from the time it became due: *Provided*, That as to any such amount which is the subject of a bona fide claim for abatement such sum of 5 per centum shall not be added and the interest from the time the amount was due until the claim is decided shall be at the rate of ½ of 1 per centum per month.

In the case of the first installment provided for in subdivision (a) the instructions printed on the return shall be deemed sufficient notice of the date when the tax is due and sufficient demand, and the taxpayer's computation of the tax on the return shall be deemed sufficient notice of the amount due.

(f) In any case in which in order to enforce payment of a tax it is necessary for a collector to cause a warrant of distraint to be served, there shall also be added as part of the tax the sum of $5.

(g) If the Commissioner finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable year then last past or the taxable year then current unless such proceedings be brought without delay, the Commissioner shall declare the taxable period for such taxpayer terminated at the end of the calendar month then last past and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of said tax as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any action or suit brought to enforce payment of taxes made due and payable by virtue of the provisions of this subdivision the finding of the Commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design. A taxpayer who is not in default in making

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any return or paying income, war-profits, or excess-profits tax under any Act of Congress may furnish to the United States, under regulations to be prescribed by the Commissioner with the approval of the Secretary, security approved by the Commissioner that he will duly make the return next thereafter required to be filed and pay the tax next thereafter required to be paid. The Commissioner may approve and accept in like manner security for return and payment of taxes made due and payable by virtue of the provisions of this subdivision, provided the taxpayer has paid in full all other income, war-profits, or excess-profits taxes due from him under any Act of Congress. If security is approved and accepted pursuant to the provisions of this subdivision and such further or other security with respect to the tax or taxes covered thereby is given as the Commissioner shall from time to time find necessary and require, payment of such taxes shall not be enforced by any proceedings under the provisions of this subdivision prior to the expiration of the time otherwise allowed for paying such respective taxes.

RECEIPTS FOR TAXES

SEC. 251. That every collector to whom any payment of any tax is made under the provisions of this title shall upon request give to the person making such payment a full written or printed receipt, stating the amount paid and the particular account for which such payment was made; and whenever any debtor pays taxes on account of payments made or to be made by him to separate creditors the collector shall, if requested by such debtor, give a separate receipt for the tax paid on account of each creditor in such form that the debtor can conveniently produce such receipts separately to his several creditors in satisfaction of their respective demands up to the amounts stated in the receipts; and such receipts shall be sufficient evidence in favor of such debtor to justify him in withholding from his next payment to his creditor the amount therein stated; but the creditor may, upon giving to his debtor a full written receipt acknowledging the payment to him of any sum actually paid and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipt.

REFUNDS

SEC. 252. That if, upon examination of any return of income made pursuant to this Act, the Act of August 5, 1909, entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," the Act of October 3, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," the Revenue Act of 1916, as amended, or the Revenue Act of 1917, it appears that an amount of income, war-profits or excess-profits tax has been paid in excess of that properly due, then, notwithstanding the provisions of section 3228 of the Revised Statutes, the amount of the excess shall be credited against any income, war-profits or excess-profits taxes, or installment thereof, then due from the taxpayer under any other return, and any balance of such excess shall be immediately refunded to the taxpayer:

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Provided, That no such credit or refund shall be allowed or made after five years from the date when the return was due, unless before the expiration of such five years a claim therefor is filed by the taxpayer.

PENALTIES

SEC. 253. That any individual, corporation, or partnership required under this title to pay or collect any tax, to make a return or to supply information, who fails to pay or collect such tax, to make such return, or to supply such information at the time or times required under this title, shall be liable to a penalty of not more than $1,000. Any individual, corporation, or partnership, or any officer or employee or any corporation or member or employee of a partnership, who willfully refuses to pay or collect such tax, to make such return, or to supply such information at the time or times required under this title, or who willfully attempts in any manner to defeat or evade the tax imposed by this title, shall be guilty of a misdemeanor and shall be fined not more than $10,000 or imprisoned for not more than one year, or both, together with the costs of prosecution.

RETURNS OF PAYMENTS OF DIVIDENDS

SEC. 254. That every corporation subject to the tax imposed by this title and every personal service corporation shall, when required by the Commissioner, render a correct return duly verified under oath, of its payments of dividends, stating the name and address of each stockholder, the number of shares owned by him, and the amount of dividends paid to him.

RETURNS OF BROKERS

SEC. 255. That every individual, corporation, or partnership doing business as a broker shall, when required by the Commissioner, render a correct return duly verified under oath, under such rules and regulations as the Commissioner, with the approval of the Secretary, may prescribe, showing the names of customers for whom such individual, corporation, or partnership has transacted any business, with such details as to the profits, losses, or other information which the Commissioner may require, as to each of such customers, as will enable the Commissioner to determine whether all income tax due on profits or gains of such customers has been paid.

INFORMATION AT SOURCE

SEC. 256. That all individuals, corporations, and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, and employers, making payment to another individual, corporation, or partnership, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in sections 254 and 255), of $1,000 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Commissioner, under such regulations and in

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such form and manner and to such extent as may be prescribed by him with the approval of the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

Such returns may be required, regardless of amounts, (1) in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations, and (2) in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by individuals, corporations, or partnerships, undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the individual, corporation, or partnership paying the income.

The provisions of this section shall apply to the calendar year 1918 and each calendar year thereafter, but shall not apply to the payment of interest on obligations of the United States.

RETURNS TO BE PUBLIC RECORDS

SEC. 257. That returns upon which the tax has been determined by the Commissioner shall constitute public records; but they shall be open to inspection only upon order of the President and under rules and regulations prescribed by the Secretary and approved by the President: *Provided*, That the proper officers of any State imposing an income tax may, upon the request of the governor thereof, have access to the returns of any corporation, or to an abstract thereof showing the name and income of the corporation, at such times and in such manner as the Secretary may prescribe: *Provided further*, That all bona fide stockholders of record owning 1 per centum or more of the outstanding stock of any corporation shall, upon making request of the Commissioner, be allowed to examine the annual income returns of such corporation and of its subsidiaries. Any stockholder who pursuant to the provisions of this section is allowed to examine the return of any corporation, and who makes known in any manner whatever not provided by law the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any such return, shall be guilty of a misdemeanor and be punished by a fine not exceeding $1,000, or by imprisonment not exceeding one year, or both.

The Commissioner shall as soon as practicable in each year cause to be prepared and made available to public inspection in such manner as he may determine, in the office of the collector in each internal-revenue district and in such other places as he may determine, lists containing the names and the post-office addresses of all individuals making income-tax returns in such district.

PUBLICATION OF STATISTICS

SEC. 258. That the Commissioner, with the approval of the Secretary, shall prepare and publish annually statistics reasonably available with respect to the operation of the income, war-profits and excess-profits tax

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laws, including classifications of taxpayers and of income, the amounts allowed as deductions, exemptions, and credits, and any other facts deemed pertinent and valuable.

COLLECTION OF FOREIGN ITEMS

SEC. 259. That all individuals, corporations, or partnerships undertaking as a matter of business or for profit the collections of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner and shall be subject to such regulations enabling the Government to obtain the information required under this title as the Commissioner, with the approval of the Secretary, shall prescribe; and whoever knowingly undertakes to collect such payments without having obtained a license therefor, or without complying with such regulations, shall be guilty of a misdemeanor and shall be fined not more than $5,000, or imprisoned for not more than one year or both.

CITIZENS OF UNITED STATES POSSESSIONS

SEC. 260. That any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States, shall be subject to taxation under this title only as to income derived from sources within the United States, and in such case the tax shall be computed and paid in the same manner and subject to the same conditions as in the case of other persons who are taxable only as to income derived from such sources.

PORTO RICO AND PHILIPPINE ISLANDS

SEC. 261. That in Porto Rico and the Philippine Islands the income tax shall be levied, assessed, collected, and paid in accordance with the provisions of the Revenue Act of 1916 as amended.

Returns shall be made and taxes shall be paid under Title I of such Act in Porto Rico or the Philippine Islands, as the case may be, by (1) every individual who is a citizen or resident of Porto Rico or the Philippine Islands or derives income from sources therein, and (2) every corporation created or organized in Porto Rico or the Philippine Islands or deriving income from sources therein. An individual who is neither a citizen nor a resident of Porto Rico or the Philippine Islands but derives income from sources therin, shall be taxed in Porto Rico or the Philippine Islands as a nonresident alien individual, and a corporation created or organized outside Porto Rico or the Philippine Islands and deriving income from sources therein shall be taxed in Porto Rico or the Philippine Islands as a foreign corporation. For the purposes of section 216 and of paragraph (6) of subdivision (a) of section 234 a tax imposed in Porto Rico or the Philippine Islands upon the net income of a corporation shall not be deemed to be a tax under this title.

The Porto Rican or Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in Porto Rico or the Philippine Islands, respectively.

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TITLE III.—WAR-PROFITS AND EXCESS-PROFITS TAX

PART I.—GENERAL DEFINITIONS

SEC. 300. That when used in this title the terms "taxable year," "fiscal year," "personal service corporation," "paid or accrued," and "dividends" shall have the same meaning as provided for the purposes of income tax in sections 200 and 201. The first taxable year for the purposes of t is title shall be the same as the first taxable year for the purposes of the income tax under Title II.

PART II.—IMPOSITION OF TAX

SEC. 301.(a) That in lieu of the tax imposed by Title II of the Revenue Act of 1917, but in addition to the other taxes imposed by this Act, there shall be levied, collected, and paid for the taxable year 1918 upon the net income of every corporation a tax equal to the sum of the following:

FIRST BRACKET

30 per centum of the amount of the net income in excess of the excess-profits credit (determined under section 312) and not in excess of 20 per centum of the invested capital;

SECOND BRACKET

65 per centum of the amount of the net income in excess of 20 per centum of the invested capital;

THIRD BRACKET

The sum, if any, by which 80 per centum of the amount of the net income in excess of the war-profits credit (determined under section 311) exceeds the amount of the tax computed under the first and second brackets.

(b) For the taxable year 1919 and each taxable year thereafter there shall be levied, collected, and paid upon the net income of every corporation (except corporations taxable under subdivision (c) of this section) a tax equal to the sum of the following:

FIRST BRACKET

20 per centum of the amount of the net income in excess of the excess-profits credit (determined under section 312) and not in excess of 20 per centum of the invested capital;

SECOND BRACKET

40 per centum of the amount of the net income in excess of 20 per centum of the invested capital.

(c) For the taxable year 1919 and each taxable year thereafter there shall be levied, collected, and paid upon the net income of every corporation which derives in such year a net income of more than $10,000 from any Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, a tax equal to the sum of the following:

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(1) Such a portion of a tax computed at the rate specified in subdivision (a) as the part of the net income attributable to such Government contract or contracts bears to the entire net income. In computing such tax the excess-profits credit and the war-profits credit applicable to the taxable year shall be used;

(2) Such a portion of a tax computed at the rate specified in subdivision (b) as the part of the net income not attributable to such Government contract or contracts bears to the entire net income.

For the purpose of determining the part of the net income attributable to such Government contract or contracts, the proper apportionment and allocation of the deductions with respect to gross income derived from such Government contract or contracts and from other sources, respectively, shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

(d) In any case where the full amount of the excess-profits credit is not allowed under the first bracket of subdivision (a) or (b), by reason of the fact that such credit is in excess of 20 per centum of the invested capital, the part not so allowed shall be deducted from the amount in the second bracket.

(e) For the purposes of the Act approved March 21, 1918, entitled "An Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes," the tax imposed by this title shall be treated as levied by an Act in amendment of Title II of the Revenue Act of 1917.

SEC. 302. That the tax imposed by subdivision (a) of section 301 shall in no case be more than 30 per centum of the amount of the net income in excess of $3,000 and not in excess of $20,000, plus 80 per centum of the amount of the net income in excess of $20,000; the tax imposed by subdivision (b) of section 301 shall in no case be more than 20 per centum of the amount of the net income in excess of $3,000 and not in excess of $20,000, plus 40 per centum of the amount of the net income in excess of $20,000; and the above limitations shall apply to the taxes computed under subdivisions (a) and (b) of section 301, respectively, when used in subdivision (c) of that section. Nothing in this section shall be construed in such manner as to increase the tax imposed by section 301.

SEC. 303. That if part of the net income of a corporation is derived (1) from a trade or business (or a branch of a trade or business) in which the employment of capital is necessary, and (2) a part (constituting not less than 30 per centum of its total net income) is derived from a separate trade or business (or a distinctly separate branch of the trade or business) which if constituting the sole trade or business would bring it within the class of "personal service corporations," then (under regulations prescribed by the Commissioner with the approval of the Secretary) the tax upon the first part of such net income shall be separately computed (allowing in such computation only the same proportionate part of the credits authorized in sections 311 and 312), and the tax upon the second part shall be the same percentage thereof as the tax so computed upon the first part is of such first part: *Provided*, That the tax upon such second part shall in no case be less than 20 per centum thereof, unless the tax upon the entire net income, if computed

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without benefit of this section, would constitute less than 20 per centum of such entire net income, in which event the tax shall be determined upon the entire net income, without reference to this section, as other taxes are determined under this title. The total tax computed under this section shall be subject to the limitations provided in section 302.

SEC. 304.(a) That the corporations enumerated in section 231 shall, to the extent that they are exempt from income tax under Title II, be exempt from taxation under this title.

(b) Any corporation whose net income for the taxable year is less than $3,000 shall be exempt from taxation under this title.

(c) In the case of any corporation engaged in the mining of gold, the portion of the net income derived from the mining of gold shall be exempt from the tax imposed by this title, and the tax on the remaining portion of the net income shall be the proportion of a tax computed without the benefit of this subdivision which such remaining portion of the net income bears to the entire net income.

SEC. 305. That if a tax is computed under this title for a period of less than twelve months, the specific exemption of $3,000, wherever referred to in this title, shall be reduced to an amount which is the same proportion of $3,000 as the number of months in the period is of twelve months.

PART III.—CREDITS

SEC. 310. That as used in this title the term "prewar period" means the calendar years 1911, 1912, and 1913, or, if a corporation was not in existence during the whole of such period, then as many of such years during the whole of which the corporation was in existence.

SEC. 311.(a) That the war-profits credit shall consist of the sum of:

(1) A specific exemption of $3,000; and

(2) An amount equal to the average net income of the corporation for the prewar period, plus or minus, as the case may be, 10 per centum of the difference between the average invested capital for the prewar period and the invested capital for the taxable year. If the tax is computed for a period of less than twelve months such amount shall be reduced to the same proportion thereof as the number of months in the period is of twelve months.

(b) If the corporation had no net income for the prewar period, or if the amount computed under paragraph (2) of subdivision (a) is less than 10 per centum of its invested capital for the taxable year, then the war-profits credit shall be the sum of:

(1) A specific exemption of $3,000; and

(2) An amount equal to 10 per centum of the invested capital for the taxable year.

(c) If the corporation was not in existence during the whole of at least one calendar year during the prewar period, then, except as provided in subdivision (d), the war-profits credit shall be the sum of:

(1) A specific exemption of $3,000; and

(2) An amount equal to the same percentage of the invested capital of the taxpayer for the taxable year as the average percentage of net income to invested capital, for the prewar period, of corporations en-

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gaged in a trade or business of the same general class as that conducted by the taxpayer; but such amount shall in no case be less than 10 per centum of the invested capital of the taxpayer for the taxable year. Such average percentage shall be determined by the Commissioner on the basis of data contained in returns made under Title II of the Revenue Act of 1917, and the average known as the median shall be used. If such average percentage has not been determined and published at least 30 days prior to the time when the return of the taxpayer is due, then for purposes of such return 10 per centum shall be used in lieu thereof; but such average percentage when determined shall be used for the purposes of section 250 in determining the correct amount of the tax.

(d) The war-profits credit shall be determined in the manner provided in subdivision (b) instead of in the manner provided in subdivision (c), in the case of any corporation which was not in existence during the whole of at least one calendar year during the prewar period, if (1) a majority of its stock at any time during the taxable year is owned or controlled, directly or indirectly, by a corporation which was in existence during the whole of at least one calendar year during the prewar period, or if (2) 50 per centum or more of its gross income (as computed under section 233 for income tax purposes) consists of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

(e) A foreign corporation shall not be entitled to a specific exemption of $3,000.

SEC. 312. That the excess-profits credit shall consist of a specific exemption of $3,000 plus an amount equal to 8 per centum of the invested capital for the taxable year.

A foreign corporation shall not be entitled to the specific exemption of $3,000.

PART IV.—NET INCOME

SEC. 320.(a) That for the purpose of this title the net income of a corporation shall be ascertained and returned—

(1) For the calendar years 1911 and 1912 upon the same basis and in the same manner as provided in section 38 of the Act entitled "An Act to provide revenue, equalise duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909, except that taxes imposed by such section and paid by the corporation within the year shall be included;

(2) For the calendar year 1913 upon the same basis and in the same manner as provided in Section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October 3, 1913, except that taxes imposed by section 38 of such Act of August 5, 1909, and paid by the corporation within the year shall be included, and except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations subject to the tax imposed by Section II of such Act of October 3, 1913, shall be deducted; and

(3) For the taxable year upon the same basis and in the same manner as provided for income tax purposes in Title II of this Act.

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(b) The average net income for the prewar period shall be determined by dividing the number of years within that period during the whole of which the corporation was in existence into the sum of the net income for such years, even though there may have been no net income for one or more of such years.

PART V.—INVESTED CAPITAL

SEC. 325.(a) That as used in this title—

The term "intangible property" means patents, copyrights, secret processes and formulæ, good will, trade-marks, trade-brands, franchises, and other like property;

The term "tangible property" means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property;

The term "borrowed capital" means money or other property borrowed, whether represented by bonds, notes, open accounts, or otherwise;

The term "inadmissible assets" means stocks, bonds, and other obligations (other than obligations of the United States), the dividends or interest from which is not included in computing net income, but where the income derived from such assets consists in part of gain or profit derived from the sale or other disposition thereof, or where all or part of the interest derived from such assets is in effect included in the net income because of the limitation on the deduction of interest under paragraph (2) of subdivision (a) of section 234, a corresponding part of the capital invested in such assets shall not be deemed to be inadmissible assets;

The term "admissible assets" means all assets other than inadmissible assets, valued in accordance with the provisions of subdivision (a) of section 326, section 330, and section 331.

(b) For the purposes of this title, the par value of stock or shares shall, in the case of stock or shares issued at a nominal value or having no par value, be deemed to be the fair market value as of the date or dates of issue of such stock or shares.

SEC. 326.(a) That as used in this title the term "invested capital" for any year means (except as provided in subdivisions (b) and (c) of this section):

(1) Actual cash bona fide paid in for stock or shares;

(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus: *Provided*, That the Commissioner shall keep a record of all cases in which tangible property is included in invested capital at a value in excess of the stock or shares issued therefor, containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, the value of the tangible property at the time paid in, the par value of the stock or shares specifically issued there-

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for, and the amount included under this paragraph as paid-in surplus. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257;

(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;

(4) Intangible property bona fide paid in for stock or shares prior to March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding on March 3, 1917, whichever is lowest;

(5) Intangible property bona fide paid in for stock or shares on or after March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year, whichever is lowest: *Provided*, That in no case shall the total amount included under paragraphs (4) and (5) exceed in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning the of taxable year; but

(b) As used in this title the term "invested capital" does not include borrowed capital.

(c) There shall be deducted from invested capital as above defined a percentage thereof equal to the percentage which the amount of inadmissible assets is of the amount of admissible and inadmissible assets held during the taxable year.

(d) The invested capital for any period shall be the average invested capital for such period, but in the case of a corporation making a return for a fractional part of a year, it shall (except for the purpose of paragraph (2) of subdivision (a) of section 311) be the same fractional part of such average invested capital.

The average invested capital for the prewar period shall be determined by dividing the number of years within that period during the whole of which the corporation was in existence into the sum of the average invested capital for such years.

SEC. 327. That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital

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or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profits upon a normal invested capital, nor (2)in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

SEC. 328.(a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similiarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

In cases in which the tax is to be computed under this section, if the tax as computed without the benefit of this section is less than 50 per centum of the net income of the taxpayer, the installments shall in the first instance be computed upon the basis of such tax; but if the tax so computed is 50 per centum or more of the net income, the installments shall in the first instance be computed upon the basis of a tax equal to 50 per centum of the net income. In any case, the actual ratio when ascertained shall be used in determining the correct amount of the tax. If the correct amount of the tax when determined exceeds 50 per centum of the net income, any excess of the correct installments over the amounts actually paid shall on notice and demand be paid together with interest at the rate of ½ of 1 per centum per month on such excess from the time the installment was due.

(c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and

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other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.

PART VI.—REORGANIZATIONS

SEC. 330. That in the case of the reorganization, consolidation, or change of ownership after January 1, 1911, of a trade or business now carried on by a corporation, the corporation shall for the purposes of this title be deemed to have been in existence prior to that date, and the net income and invested capital of such predecessor trade or business for all or any part of the prewar period prior to the organization of the corporation now carrying on such trade or business shall be deemed to have been the net income and invested capital of such corporation. If such predecessor trade or business was carried on by a partnership or individual the net income for the prewar period shall, under regulations prescribed by the Commissioner with the approval of the Secretary, be ascertained and returned as nearly as may be upon the same basis and in the same manner as provided for corporations in Title II, including a reasonable deduction for salary or compensation to each partner or the individual for personal services actually rendered.

In the case of the organization as a corporation before July 1, 1919, of any trade or business in which capital is a material income-producing factor and which was previously owned by a partnership or individual, the net income of such trade or business from January 1, 1918, to the date of such reorganization may at the option of the individual or partnership be taxed as the net income of a corporation is taxed under Titles II and III; in which event the net income and invested capital of such trade or business shall be computed as if such corporation had been in existence on and after January 1, 1918, and the undistributed profits or earnings of such trade or business shall not be subject to the surtax imposed in section 211, but amounts distributed on or after January 1, 1918, from the earnings of such trade or business shall be taxed to the recipients as dividends, and all the provisions of Titles II and III relating to corporations shall so far as practicable apply to such trade or business: *Provided*, That this paragraph shall not apply to any trade or business the net income of which for the taxable year 1918 was less than 20 per centum of its invested capital for such year: *Provided further*, That any taxpayer who takes advantage of this paragraph shall pay the tax imposed by section 1000 of this act and by the first subdivision of section 407 of the Revenue Act of 1916, as if such taxpayer had been a corporation on and after January 1, 1918, with a capital stock having no par value.

If any asset of the trade or business in existence both during the taxable year and any prewar year is included in the invested capital for the taxable year but is not included in the invested capital for such prewar year, or is valued on a different basis in computing the invested capital for the taxable year and such prewar year, respectively, then under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary such readjustments shall be made as are necessary to place the computation of the invested capital for such prewar year on the basis employed in determining the invested capital for the taxable year

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SEC. 331. In the case of the reorganisation, consolidation, or change of ownership of a trade or business, or change of ownership of property, after March 3, 1917, if an interest or control in such trade or business or property of 50 per centum or more remains in the same persons, or any of them, then no asset transferred or received from the previous owner shall, for the purpose of determining invested capital, be allowed a greater value than would have been allowed under this title in computing the invested capital of such previous owner if such asset had not been so transferred or received: *Provided*, That if such previous owner was not a corporation, then the value of any asset so transferred or received shall be taken at its cost of acquisition (at the date when acquired by such previous owner) with proper allowance for depreciation, impairment, betterment or development, but no addition to the original cost shall be made for any charge or expenditure deducted as expense or otherwise on or after March 1, 1913, in computing the net income of such previous owner for purposes of taxation.

PART VII.—MISCELLANEOUS

SEC. 335.(a) That if a corporation (other than a personal service corporation) makes return for a fiscal year beginning in 1917 and ending in 1918, the tax for the first taxable year under this title shall be the sum of:

(1) The same proportion of a tax for the entire period computed under Title II of the Revenue Act of 1917 which the portion of such period falling within the calendar year 1917 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rate specified in subdivision (a) of section 301 which the portion of such period falling within the calendar year 1918 is of the entire period. Any amount heretofore or hereafter paid on account of the tax imposed for such fiscal year by Title II of the Revenue Act of 1917 shall be credited toward the payment of the tax imposed for such fiscal year by this title, and if the amount so paid exceeds the amount of the tax imposed by this title, the excess shall be credited or refunded to the corporation in accordance with the provisions of section 252.

(b) If a corporation makes return for a fiscal year beginning in 1918 and ending in 1919, the tax for such fiscal year under this title shall be the sum of: (1) the same proportion of a tax for the entire period computed under subdivision (a) of section 301 which the portion of such period falling within the calendar year 1918 is of the entire period, and (2) the same proportion of a tax for the entire period computed under subdivision (b) or (c) of section 301 which the portion of such period falling within the calendar year 1919 is of the entire period.

(c) If a partnership or a personal service corporation makes return for a fiscal year beginning in 1917 and ending in 1918, it shall pay the same proportion of a tax for the entire period computed under Title II of the Revenue Act of 1917 which the portion of such period falling within the calendar year 1917 is of the entire period.

Any tax paid by a partnership or personal service corporation for any period beginning on or after January 1, 1918, shall be immediately

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refunded to the partnership or corporation as a tax erroneously or illegally collected.

SEC. 336. That every corporation, not exempt under section 304, shall make a return for the purposes of this title. Such returns shall be made, and the taxes imposed by this title shall be paid, at the same times and places, in the same manner, and subject to the same conditions, as is provided in the case of returns and payment of income tax by corporations for the purposes of Title II, and all the provisions of that title not inapplicable, including penalties, are hereby made applicable to the taxes imposed by this title.

SEC. 337. That in the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this title attributable to such sale shall not exceed 20 per centum of the selling price of such property or interest.

GENERAL AND ADMINISTRATIVE PROVISIONS

SEC. 1305. That all administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this Act, and every person liable to any tax imposed by this Act, or for the collection thereof, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return or such statements as he deems sufficient to show whether or not such person is liable to tax.

The Commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is hereby authorized, by any revenue agent or inspector designated by him for that purpose, to examine any books, papers, records or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons.

* * * * *

SEC. 1309. That the Commissioner, with the approval of the Secretary, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act.

* * * * *

SEC. 1313. That in the payment of any tax under this Act not payable by stamp a fractional part of a cent shall be disregarded unless it

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amounts to one-half cent or more in which case it shall be increased to 1 cent.

* * * * *

SEC. 1314. That collectors may receive, at par with an adjustment for accrued interest, certificates of indebtedness issued by the United States and uncertified checks in payment of income, war-profits and excess-profits taxes and any other taxes payable other than by stamp, during such time and under such regulations as the Commissioner with the approval of the Secretary, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions the same as if such check had not been tendered.

* * * * *

SEC. 1318. That if any person is summoned under this Act to appear, to testify, or to produce books, papers or other data, the district court of the United States for the district in which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

The district courts of the United States at the instance of the United States are hereby invested with such jurisdiction to make and issue, both in actions at law and suits in equity, writs and orders of injunction, and of ne exeat republica, orders appointing receivers, and such other orders and process, and to render such judgments and decrees, granting in proper cases both legal and equitable relief together, as may be necessary or appropriate for the enforcement of the provisions of this Act. The remedies hereby provided are in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such provisions.

* * * * *

SEC. 1320. That wherever by the laws of the United States or regulations made pursuant thereto, any person is required to furnish any recognizance, stipulation, bond, guaranty, or undertaking, hereinafter called "penal bond," with surety or sureties, such person may, in lieu of such surety or sureties, deposit as security with the official having authority to approve such penal bond, United States Liberty bonds or other bonds of the United States in a sum equal at their par value to the amount of such penal bond required to be furnished, together with an agreement authorizing such official to collect or sell such bonds so deposited in case of any default in the performance of any of the conditions or stipulations of such penal bond. The acceptance of such United States bonds in lieu of surety or sureties required by law shall have the same force and effect as individual or corporate sureties, or certified checks, bank drafts, post-office money orders, or cash, for the penalty or amount of such penal bond. The bonds deposited hereunder, and such other United States bonds as may be substituted therefor from time to time as such security, may be deposited with the Treasurer, or an Assistant Treasurer of the United States, a Government depository, Federal Reserve bank, or member bank, which shall issue receipt therefor, describing such bonds so deposited. As soon as security for the performance of such penal bond is no longer necessary,

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such bonds so deposited shall be returned to the depositor: *Provided*. That in case a person or persons supplying a contractor with labor or material as provided by the Act of Congress, approved February 24, 1905 (33 Stat., 811), entitled "An Act to amend an Act approved August thirteenth, eighteen hundred and ninety-four, entitled 'An Act for the protection of persons furnishing materials and labor for the construction of public works'," shall file with the obligee, at any time after a default in the performance of any contract subject to said Acts, the application and affidavit therein provided, the obligee shall not deliver to the obligor the deposited bonds nor any surplus proceeds thereof until the expiration of the time limited by said Acts for the institution of suit by such person or persons, and, in case suit shall be instituted within such time, shall hold said bonds or proceeds subject to the order of the court having jurisdiction thereof: *Provided further*, That nothing herein contained shall affect or impair the priority of the claim of the United States against the bonds deposited or any right or remedy granted by said Acts or by this section to the United States for default upon any obligation of said penal bond: *Provided further*, That all laws inconsistent with this section are hereby so modified as to conform to the provisions hereof: *And provided further*, That nothing contained herein shall affect the authority of courts over the security, where such bonds are taken as security in judicial proceedings, or the authority of any administrative officer of the United States to receive United States bonds for security in cases authorized by existing laws. The Secretary may prescribe rules and regulations necessary and proper for carrying this section into effect.

* * * * *

SEC. 1400. (a) That the following parts of Acts are hereby repealed, subject to the limitations provided in subdivision (b):

(1) The following titles of the Revenue Act of 1916:

Title I (called "Income Tax");

Title II (called "Estate Tax");

Title III (called "Munitions Manufacturers' Tax"), as amended;

Title IV (called "Miscellaneous Taxes").

(2) The following parts of the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes," approved March 3, 1917:

Title III (called "Estate Tax");

Section 402 (called "Returns of Dividends").

(3) The following titles of the Revenue Act of 1917:

Title I (called "War Income Tax");

Title II (called "War Excess-Profits Tax");

Title III (called "War Tax on Beverages");

Title IV (called "War Tax on Cigars, Tobacco, and Manufactures Thereof");

Title V (called "War Tax on Facilities Furnished by Public Utilities, and Insurance");

Title VI (called "War Excise Taxes");

Title VII (called "War Tax on Admissions and Dues");

Title VIII (called "War Stamp Taxes");

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Title IX (called "War Estate Tax");
Title X (called "Administrative Provisions");
Title XII (called "Income-Tax Amendments").

(b) Such parts of Acts shall remain in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued and may accrue in relation to any such taxes, and except that the unexpended balance of any appropriation heretofore made and now available for the administration of any such part of an Act shall be available for the administration of this Act or the corresponding provisions thereof: *Provided*, That, except as otherwise provided in this Act, no taxes shall be collected under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917, or Title I or II of the Revenue Act of 1917, in respect to any period after December 31, 1917: *Provided further*, That the assessment and collection of all estate taxes, and the imposition and collection of all penalties or forfeitures, which have accrued under Title II of the Revenue Act of 1916 as amended by the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes," approved March 3, 1917, or Title IX of the Revenue Act of 1917, shall be according to the provisions of Title IV of this Act. In the case of any tax imposed by any part of an Act herein repealed, if there is a tax imposed by this Act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act.

Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 shall remain in force for the assessment and collection of the income tax in Porto Rico and the Philippine Islands, except as may be otherwise provided by their respective legislatures.

* * * * *

SEC. 1402. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of this Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment has been rendered.

* * * * *

SEC. 1408. That every person who on or after April 6, 1917, has entered into any contract, undertaking, or agreement with the United States, or with any department, bureau, officer, commission, board, or agency under the United States or acting in his behalf, or with any other person having contract relations with the United States, for the performance of any work or the supplying of any materials or property for the use of or for the account of the United States, shall, within thirty days after a request of the Commissioner therefor, file with the Commissioner a true and correct copy of every such contract, undertaking, or agreement.

Whoever fails to comply with such request of the Commissioner

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shall be guilty of a misdemeanor and shall be punished by a fine of not more than $1,000, or by imprisonment for not more than one year, or both.

The Commissioner shall (when not violative of the technical military or naval secrets of the Government) have access to all information and data relating to any such contract, undertaking, or agreement, in the possession, control or custody of any department, bureau, board, agency, officer or commission of the United States and may call upon any such department, bureau, board, agency, officer or commission for a full statement and description of any allowance for amortization, obsolescence, depreciation or loss, or of any valuation, appraisal, adjustment or final settlement, made in pursuance of any such contract, undertaking, or agreement.

SEC. 1409. That unless otherwise herein specially provided, this Act shall take effect on the day following its passage.

Approved, February 24, 1919.

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Foreign Trade and the Interior Bank

Guaranty Trust Company
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Foreign Trade and the Interior Bank

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Foreign Trade and the Interior Bank

UP to the present time the banks in the interior of the United States have played a comparatively small part in the development of our foreign trade. As a result of the war, this country has been forced into many new industrial and financial activities that reach out into every foreign country, activities which affect the welfare of the smaller communities nearly as much as they do those of the larger cities. Manufacturers in small towns throughout the United States have become interested in the possibilities of foreign markets, and they naturally are looking to their local banks to advise them regarding their foreign trade problems, both actual and potential. We believe that the time has come for the interior bank to realize that its business is the same as all others—that the biggest thing it has to sell is *service*, and that at the present moment one of its greatest opportunities for service is to aid in the development of American foreign trade.

To Keep Industries Busy

We have learned by recent experience that the factories of America are today so huge and their

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output at full capacity is so great that the domestic market cannot regularly absorb it. It is only by a constant flow of overseas trade that we can run full time all the time. To do less than that means homes in America in which the breadwinner is out of work. It means "part time" in many factories, or mills that are entirely shut down. Additional orders from any source tend to reduce overhead expenses of production, and tend also to reduce the cost of raw materials by increasing the quantity bought. All the advantages of large scale production come into play when these export orders are received.

Increased orders from foreign countries tend to change the seasonal demands to year round demands. The manufacturer who has a market for his goods in South America, for instance, possesses a great advantage, because the seasons there are exactly the reverse of our own. And so, because the markets of all the world are greater and steadier than the markets of any one country, the American manufacturer and merchant must cultivate the foreign field, and the interior bank, in coöperation with the international bank, must be prepared to offer facilities necessary for the prompt and efficient handling of foreign trade transactions.

The Stake of the Interior Bank

That the interior bank is vitally interested in the development of foreign trade is evident from

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the fact that a large proportion of the manufactured goods exported from the United States is produced in towns with a population of fifty thousand or less. There are two thousand one hundred and forty-nine towns of this size. As to our import trade, it is only necessary to point out, for instance, that Akron, Ohio, with a population of one hundred and fifty thousand, buys about one-fourth of all the crude rubber in the world. In four hundred and sixteen cities of ten thousand to twenty-five thousand, in 1914, the total value of manufactured products was $3,261,395,000.

Unlimited Possibilities

Cities of fifty thousand and under make up a large proportion of our manufacturing area and present almost unlimited possibilities from the foreign trade standpoint. There are one hundred and thirty-three towns of this size in Indiana, and the same number in Massachusetts. The most cursory examination of the manufacturing facilities of these hundreds of small towns reveals their possibilities from a foreign trade point of view.

And the manufacturers in those towns are no longer groping in the dark in regard to foreign affairs. Practically all of them are members of powerful trade associations. They journey in large numbers from the small interior towns to New York or San Francisco to attend foreign trade conventions, and they are diligent readers of for-

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eign trade publications. But, in far too many cases, when they go back home they do not find in their own town the facilities for obtaining the information for transacting their foreign business. Export shipments are made constantly from all these small towns. Imports of raw materials needed in our industries are constantly flowing from the seaboard to the interior. All these transactions involve the services of banks. The interior bank may interpose itself as a useful link in the system of overseas trade.

Increasing Interest in Foreign Trade

How widely distributed is the interest in foreign trade is plainly shown by a study of the letters received by the International Trade Service of the Guaranty Trust Company of New York from the smaller towns throughout the United States, which indicate an increasing interest in foreign trade on the part not only of the interior banks but of the local manufacturers.

Danville, Va., is interested in sending tobacco to Venezuela; La Porte, Ind., wants to send farm tractors to Brazil; Austin, Texas, desires to import French novelties; St. Joseph, Mich., desires an agent for automobile accessories in India; Durgettstown, Pa., sends an inquiry regarding industrial enterprises in Jugoslavia; Parkersburg, W. Va., wants to sell oil well supplies to Mexico; Keokuk, Iowa, is interested in developing a mar-

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ket for rolled oats in South America; Coshocton, Ohio, wants to appoint an agent in Spain for its glass bottles; Lompog, Cal., is interested in the importation of mustard seed from the Dutch East Indies; Cadillac, Mich., desires to ship veneer to New Zealand; Monessen, Pa., is interested in steel wire in South Africa; Charlotte, N. C., wants to send cotton to Finland; Norfolk Downs, Mass., has a customer for weighing machinery in Formosa; Mount Pleasant, Mich., has a customer for trucks in Guatemala, and Valdosta, Ga., wants to export cotton linters to Czechoslovakia.

World-wide Facilities Available

It is obvious that the interior bank cannot set up elaborate machinery and an expensive personnel equipped to answer specific inquiries regarding foreign trade. The international bank has, however, built up a worldwide network of branches, affiliations and special correspondents, backed up by staffs of experts in the metropolis, which is freely offered to the interior banker in order to assist him to develop the foreign trade of his community. The international bank has, in fact, created facilities which make it possible for the exporting and importing clients of the inland bank to do business on a safe basis with the merchant in the interior of China, the ranchman in Australia, the miner in Africa, and the planter in Latin-America.

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To illustrate concretely just what this means, let us examine the facilities which are offered to the interior bank by the large international financial institutions. First of all, they have direct banking connections with Great Britain and Continental Europe, the Near East, Latin-America, South Africa and Australasia, with China, Japan, British India, the Dutch East Indies, and with the Straits Settlements. They are in direct and constant communication with thousands of correspondents in every trade center of any importance throughout the world.

Specific Information Obtainable

In their foreign trade services these international banks have created departments to give specific commercial information, by interview or by mail, regarding the prospect for the sale of American goods abroad. They have immediate access to reports regarding the credit and commercial standing of hundreds of thousands of foreign firms and corporations, all of them carefully revised to cover changes made during the war.

These departments include in their personnel experts on tariffs, marine insurance, freights, forwarding, customs duties and shipping documents, and men who have traveled extensively in foreign countries. Supplementing their personal knowledge of foreign countries and of the manners and

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customs of the peoples inhabiting them is a daily service of information by mail, wire and cable from private and official sources and from their branches, subsidiaries and agents throughout the world regarding changing conditions, new demands for American products and movements of foreign buyers. Over the desks of these experts there passes each day a large quantity of written and printed material in all languages, and items of interest to American exporters and importers are sent out promptly to specially selected mailing lists.

A Concrete Example

Here is a concrete example of the kind of service which an interior bank should be able to render: In an Illinois town of about ten thousand inhabitants there is a small factory manufacturing a line of tools. As a result of advertising in export journals, this manufacturer received an order from Buenos Aires for two thousand dollars' worth of goods. The buyer stipulated that the merchandise was to be sent forward with draft attached to documents, which were to be delivered against the acceptance of the draft at 60 days' sight. It was the manufacturer's first export order, and he went immediately to his local bank for advice as to how the goods should be packed for export to Argentina and what railroad and shipping documents were needed, and above all how he was to

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get his money. The interior bank was able, through coöperation with its banking correspondent in New York, to obtain a quick report on the credit standing of the Argentine customer, which showed that he was a perfectly good credit risk. Information was also supplied as to packing and shipping, and the interior bank was able to aid its customer in financing the transaction.

Creating Local Interest

There are a number of ways in which the interior banker can foster interest in foreign trade in his community. One of the most effective methods is to obtain the support of the leading local newspaper. The editors of the progressive newspapers of our inland cities fully recognize the importance of foreign trade, but are frequently at a loss to obtain a sufficient amount of material to run a regular foreign trade department. Arrangements can be made for supplying newspaper features, as well as a continuous supply of foreign trade news.

The local public library is another institution which can be utilized most effectively in foreign trade promotion. It should be supplied with a good selection of books on foreign commerce, foreign countries, and foreign travel, commercial geography, international law, tropical and subtropical and other imported commodities, atlases, books on shipping, on marine insurance and for-

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eign exchange, international banking, and ports and harbors. The local schools can do similar work.

Proper Organization Necessary

Most important of all, however, is the proper organization of the business men of the community. The Chamber of Commerce, if it has not already done so, should form a foreign trade committee to make a survey of the foreign trade activities of its members. It should maintain an up-to-date list of all members doing an exporting or importing business, with full details of the commodities handled and of the foreign countries in which the members are interested. A foreign trade reference library should be installed in the local Chamber of Commerce, which should contain directories of foreign markets and directories and lists of American exporters, exporting manufacturers, dealers and commission houses. This reference library should receive regularly all the publications of the Bureau of Foreign and Domestic Commerce.

Direct contact should be established with the American commercial attaches and trade commissioners maintained by that Bureau in foreign countries. Arrangements should be made to obtain regularly the foreign trade publications of the National Foreign Trade Council, the American Manufacturers Export Association, and of the

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large banks which specialize in foreign trade. Subscriptions should be made to the leading export trade journals. All this information can be obtained and classified for the use of local manufacturers with very little trouble and expense. Foreign visitors to this country should be encouraged to visit the local manufacturing plants. Another effective method of obtaining information direct from foreign sources is for the local Chamber of Commerce to arrange for the exchange of membership and services with American Chambers of Commerce in foreign countries.

The Importance of Import Trade

It cannot be too strongly emphasized that the interior banker has an important part to play in the development of our import trade, as well as that of our exports. Our dependence upon other countries for foodstuffs and raw materials grows constantly greater with the increase in our population and the productive capacity of our industries.

In order to provide a sustained market for our surplus manufactures, we must have a regular and increasing supply of many commodities which are not produced in the United States, or which are produced in such small volume as to be entirely inadequate for our requirements. We must obtain manganese for our steel mills from Russia and South America. Our tanneries must have quebracho from Argentina; our automobile tire in-

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dustry must obtain crude rubber from Brazil; our machine shops, rail mills, armored plate works, and wire rope factories must have nickel from Canada and New Caledonia; our tinplate manufacturers must import their tin from the Malay Straits and from Bolivia; our silk factories must get their raw product from China and Japan; our clothing wools must be imported from Australia and Argentina; our manufacturers of twines, canvas, linens and laces must get their flax from Russia and Belgium; our burlap makers must get their jute from India; the sisal which is used to make our binder twine, which is so essential in the harvesting of our crops, must come from Yucatan. We must also import large quantities of cocoanut oil and other vegetable oils from the Dutch East Indies and from the Pacific isles; coffee from Brazil, tea from China, India, Japan and Java; cocoa from Venezuela; sugar from Cuba; rice from the Far East; spices from the East Indies; platinum from Colombia; and vanadium from Peru.

Must Assist Importer

The list could be made very much longer, but the foregoing is sufficient to prove the dependence of many of our important industries on the raw products of other countries. The interior banker must be prepared to offer facilities to his importing clients who wish to buy these commodities in

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distant lands. He must be able to help the local importer to locate sources of raw materials, advise him regarding reliable foreign exporters and market conditions, and on how he may establish the necessary import credits through his relations with the international banker.

It cannot be too strongly emphasized that in the long run international trade must be to a large extent the exchange of goods for goods. In encouraging Europe and other countries to liquidate their debt to us in goods—for they cannot send us gold without further depreciating their inflated currencies—it does not mean that this debt can be liquidated only in articles of European origin. For example, Great Britain might offset her adverse trade balance with us on direct interchange of commodities by a debit balance owing by us on our imports of jute from India, wool from Australia, hides, skins and wool from South Africa, etc. A debit balance owing by the United States to Argentina for our imports of the raw products of that country could be offset against the balance due from Argentina to England, and in turn by England against the United States.

How Exchange Works Against Us

It is only by increasing their exports that Europe and Latin-America can overcome the exchange handicap which makes it so difficult for them to buy American products. To illustrate how the

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exchange problem works to the disadvantage of the American exporter, take the case of an importer in Argentina who is in the market for American farming implements. The dollar is (at the end of 1920) at a premium in Argentina, as it is in all South American countries. The Argentine buyer, in converting his pesos into American dollars today, must pay a premium of about 25 per cent. over the normal rate of exchange. Under the circumstances it is quite likely that he will purchase British goods, because the exchange rate on the pound sterling is much more in his favor. This exchange handicap against American exporters will increase, not only in Argentina but throughout the world, if we continue to export at the recent high price levels without a corresponding increase in imports.

Importance of the Edge Law

If our foreign trade is not to suffer through inadequate financing, we must give thought to some form of long-term credits in order to supplement the operations of the international banks and to make liquid the frozen long-term credits in foreign markets. To meet this situation the Edge Law was recently passed. This law gives us, for the first time in our history, financial organizations for the express purpose of assisting foreign trade through long-term investments. The original Federal Reserve Act authorized the establishment of

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branches by our national banks in foreign countries. The Edge Law goes one step further in providing for the formation of these foreign investment banks under Federal charter. A most important provision of the Edge Law is that which permits corporations formed under its provisions to issue their own notes and debentures for sale to investors.

How Interior Banker Can Help

The interior banker has here a very definite part to play in educating his community in the relation which our overseas commerce bears to domestic prosperity and in pointing out the desirability of such securities in order to make possible a continuous and increasing flow of foreign orders. The interior banker should be the point from which should radiate the facts and figures to show that the local manufacturer, the farmer and all their employees have a direct personal interest in maintaining our export trade in order to avert the slowing up of production, reduction of wages, and unemployment.

In order that the grain produced in the agricultural sections may be sold abroad and thus produce domestic prosperity, which in turn will increase local prosperity, the interior banker should spread far and wide the fact—supported by simple illustrations—that domestic prosperity is absolutely dependent upon the marketing abroad

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of the surpluses of American products. The extension of export credits by Edge Law corporations will enable Europe to buy American wheat, rye, corn, meats, pelts, and wool, as well as many classes of manufactured goods.

Every Community Directly Interested

A recent analysis of the cargo carried by a United Fruit liner sailing from New Orleans to South American ports showed that practically every community in the United States, manufacturing or agricultural, had some part in the production of the cargo sent out in this steamer. Hardware factories in thousands of small towns are dependent upon our export trade. Agriculture is interested not only in the direct export of raw farm products, but it has a very great interest in the export of manufactures produced in America from farm products such as cotton goods and tobacco manufactures of all kinds. Breeders of pure bred stock are interested in the possibilities of South America. The fruit and vegetable growers, the poultry trade producers, the honey and nut producers, the dairymen and canners are all alive to the possibilities and seek information and assistance in the development of new markets.

The surplus of our Western agricultural products is consumed by Europe, and thereby prices are sustained. Foreign trade is of great importance to the South because foreign countries consume

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65 or 70 per cent. of our cotton. The products of the factories of the North and East are sold throughout the world, thus furnishing work and wealth for millions of people. In 1919, we exported eighteen million cases of canned milk, thirty-four million pounds of butter, fourteen million pounds of cheese, six and a half million bales of cotton and six hundred and eighty million yards of cotton cloth.

It need hardly be pointed out that the success of our foreign trade depends to a greater extent upon the bank than upon any other single agency at the command of business. It has been truthfully said that the international bank of today is the outpost of business, and the role of the interior bank is certainly equally important. Between them—the interior bank and the international bank—they must translate our business ways to the foreign buyer and seller and translate the ways of the foreign buyer and seller to us.

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Ownership Certificates

under the

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including

Returns of Information
and Withholding

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Foreword

THIS booklet is designed to give briefly and clearly the requirements of the law and regulations, relating to withholding and information at the source, and the use of the various forms prescribed by the Treasury Department. When preparing certificates to accompany coupons presented for payment, the chart on page 21 will be found of much assistance in selecting the proper form to be used and line and column on the form in which the amount of the interest or dividend is to be entered.

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Withholding of Tax at Source

Classes of Income Subject to Withholding

Under the Revenue Law of 1918, income subject to withholding of the tax at the source may be divided into three classes:

(1) Miscellaneous fixed or determinable, annual or periodical gains, profits and income, payable to nonresident alien individuals and foreign corporations not engaged in business in the United States and not having an office or place of business therein;

(2) Interest on bonds of domestic corporations not containing a "tax-free" covenant clause, payable to nonresident alien individuals and foreign corporations not engaged in business in the United States and not having an office or place of business therein;

(3) Interest on bonds of domestic corporations containing a "tax-free" covenant clause, payable to nonresident alien individuals, to foreign corporations not engaged in business in the United States and not having an office or place of business therein, to citizens of the United States, to alien residents of the United States, or to domestic or foreign partnerships, or personal service corporations (see page 6).

Other payments of income are not subject to withholding of the tax at the source and in no case is there any withholding of tax at the source on income payable to domestic corporations or to foreign corporations having an office or place of business in the United States.

Income Other Than "Tax-Free" Covenant Bond Interest

Individuals and Fiduciaries

Under the Revenue Act of 1918, payments of interest, rent, salaries, wages, and all other fixed or determinable annual or

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periodical income made to nonresident alien individuals and to nonresident alien fiduciaries, except—

(a) income derived from dividends on stocks of corporations subject to income tax;
(b) interest on bonds or similar obligations of corporations, containing a "tax-free" covenant clause; or
(c) items upon which personal exemption is claimed,

is subject to withholding of tax at the source at the rate of 8 per centum.

Corporations

Fixed or determinable annual or periodical income, with the exceptions stated in the foregoing paragraph, payable to foreign corporations not engaged in trade or business in the United States and not having an office or place of business therein, is subject to withholding of tax at the source at the rate of 10 per centum.

Domestic banks are now required to withhold tax on interest on bank deposits of foreign corporations, not having an office or place of business in the United States, including foreign banks, and such withholding applies to interest credited on and after February 25, 1919.

Partnerships and Personal Service Corporations

Withholding is required at the rate of 2 per centum in the case of interest payable to a partnership, whether resident or nonresident, upon bonds or obligations of domestic or resident corporations containing a "tax-free" covenant clause, which is also the case with respect to a corporation which has received notice from the Income Tax Unit of the Treasury Department that its return as a personal service corporation has been approved. Other fixed or determinable annual or periodical income payable to resident or nonresident alien partnerships is not subject to withholding of tax at the source.

Exemption from Withholding on Salaries of Nonresident Alien Individuals

A nonresident alien individual who receives salaries, wages, or other fixed or determinable annual or periodical compensa-

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tion from sources within the United States, is permitted to claim the personal exemption or exemption for dependents, if the country of which he is a citizen or subject allows a similar credit for personal exemption or exemption for dependents to citizens of the United States not residing in such country. This exemption may be claimed by filing with the employer, Form 1115 (page 55), duly filled out and executed under oath. If it appears that such employee is entitled to the credit and that such credit has not yet been exhausted, the employer need not, until such credit is in fact exhausted, withhold any tax from payments of salary, wages, or other compensation made to such employee.

A nonresident alien individual, who is a citizen or subject of the following countries, is entitled, for the purpose of the normal tax, to such credit for personal exemption and for dependents as his family status may warrant:

Argentina	Galicia	Roumania
Belgium	Goritz	Russia (including Poles owing allegiance to Russia)
Bohemia	Gradisca	
Bolivia	Herzegovina	
Bosnia	Istria	Salzburg
Brazil	Lower Austria	Santa Domingo
Bukowina	Mexico	Serbia
Canada	Montenegro	Siam
Carinthia	Moravia	Silesia
Carniola	Morocco	Spain
Chile	Newfoundland	Styria
China	Nicaragua	Switzerland
Cuba	Norway	Trieste
Dalmatia	Panama	Tyrol
Denmark	Paraguay	Upper Austria
Ecuador	Persia	Union of South Africa
Egypt	Peru	
France	Portugal	Venezuela.

A nonresident alien individual, who is a citizen or subject of the following countries, is entitled to a credit for personal exemption, but is not entitled to a credit for dependents:

Bachka	Salvador	Slavonia
Banat of Temesvar	India	Slovakia
Croatia	Italy	Transylvania.

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A nonresident alien individual, who is a citizen or subject of the following countries, is not entitled to credit for either a personal exemption or for dependents:

Australia	Great Britain	The Netherlands
Costa Rica	or Ireland	New Zealand
	Japan	Sweden.

If a nonresident alien individual is a citizen or subject of a country not included in any of the above lists, then, in order to secure credit for either the personal exemption or exemption for dependents, he must prove to the satisfaction of the Commissioner of Internal Revenue, either (a) that his country does not impose an income tax, or (b) that in imposing an income tax, it grants the similar credit required by the Revenue Act of 1918.

Income of Nonresident Alien Not Subject to Tax

Salaries, wages, commissions, and rents paid by domestic business enterprises to nonresident alien employees for services rendered entirely in a foreign country or for property located in a foreign country, are not subject to tax as income from sources within the United States. Interest on notes of a corporation organized in the United States, but doing no business and owning no property therein, paid to a nonresident alien is also not subject to tax. Likewise, the tax does not apply to charter money or freight shipments received by a foreign owner in regard to a vessel operated between the United States and foreign ports, if the person receiving the income maintains no regular agency in the United States and is not doing business in the United States, or to compensation received by nonresident alien purchasing agents from foreign governments. Accordingly, no withholding or reports of information are required in connection with payments of income as described above.

"Tax-Free" Covenant Bonds

Interest on bonds, containing a "tax-free" covenant clause, of domestic and resident corporations (and of foreign corpo-

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rations having a paying agent in this country*), is subject to withholding at the rate of 2 per centum when such interest is payable to

(a) citizens or residents of the United States,
(b) nonresident alien individuals,
(c) partnerships (resident or nonresident),
(d) personal service corporations,**
(e) foreign corporations not engaged in business in the United States and not having an office or place of business therein,
(f) resident fiduciaries,
(g) nonresident fiduciaries,
(h) owners unknown.

In the collection of such interest, Form 1000 (page 23) should be used.

The effect of the provision requiring the deduction of the tax of 2 per centum in the case of "tax-free" securities is to bind the debtor corporation to pay the normal tax to the extent of 2 per centum or less, according to the terms of the particular covenant. Insofar as the owner of such bond is concerned, there is no actual deduction of the tax when the corporation assumes at least 2 per centum. The owner, in such cases, receives the face value of the coupons if the corporation assumes the normal tax of 2 per centum, or the face value of the coupon, less any part of 2 per centum which the debtor corporation does not assume.

For example, on coupons amounting to $100, if the corporation assumes the payment of the normal tax of 2 per centum or more, the face value of the coupon will be paid to the bondholder, and the bondholder will take credit in his income tax return for the amount of the tax paid by the corporation. If the corporation, however, assumes the payment of only 1 per centum of the normal tax, the debtor corporation will pay 1 per centum and deduct 1 per centum, the owner of the bonds receiving $99 and taking credit on his return for the payment of tax equal to 2 per centum.

Withholding of tax at the source from interest on bonds or

*Withholding applicable only when interest is payable to an individual citizen or resident of the United States or to a resident partnership or personal service corporation (see page 6).
**See page 6.

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other obligations containing a "tax-free" covenant, shall not be required in the case of a citizen or resident alien individual, if he files with the withholding agent, when presenting interest coupons for payment or not later than February 1st following the taxable year, an ownership certificate Form 1001 (page 25), claiming credit for the personal exemption or exemption for dependents.

In case a nonresident alien is entitled to a like exemption under Treasury Regulations and his gross income from sources within the United States (including bond interest) does not exceed his personal exemption and credit for dependents, in addition to certificate Form 1000, he should also file at the end of the calendar year, but not later than February 1, certificate Form 1001-B (page 29).

Domestic and resident corporations and foreign corporations having an office or place of business in the United States when collecting interest on "tax-free" covenant bonds, should file certificate Form 1001, since the law does not require withholding of tax in the case of domestic and resident corporations and foreign corporations having an office or place of business in the United States. For this reason, a domestic corporation or a foreign corporation having an office or place of business in the United States does not receive the benefit of the "tax-free" covenant in the bonds unless the taxpayer is reimbursed by the corporation.

When certificate Form 1001 or Form 1001-B is so filed, the debtor corporation is relieved from paying the tax.

Tax Paid by Debtor Corporation

The amount of income tax paid for a bondholder by an obligor pursuant to a "tax-free" covenant in its bonds, is held by the Treasury Department to be in the nature of additional interest paid to the bondholder and must be included under gross income in the income tax return of the bondholder. The tax so paid by the obligor corporation, however, cannot be deducted from gross income in the return of the corporation.

Owner of Bonds or Securities Unknown

Withholding of tax at the source in all cases at the highest applicable rate is also required from interest on bonds or other

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similar obligations where the owner of such bonds is unknown to the withholding agent. The "highest applicable rate" as used herein is

(a) 2 per centum in the case of interest upon bonds or other obligations of domestic or resident foreign corporations containing a "tax-free" covenant, and
(b) 8 per centum in the case of other fixed or determinable annual or periodical income (other than dividends from corporations liable to income tax).

In such cases, the first bank receiving the coupons shall require of the payee, an affidavit showing—

(a) name and address of the payee;
(b) name and address of the debtor corporation;
(c) date of maturity of the interest;
(d) name and address of the person from whom the coupons were received;
(e) amount of interest;
(f) statement that the owner of the bonds is unknown to the payee.

The first bank shall also prepare ownership certificate, Form 1000 (page 23), crossing out "owner" and inserting "payee," entering the amount of the interest on line 6, and stamping or writing across the face of the certificate "Affidavit furnished," adding the name of the bank.

The affidavit and certificate must be forwarded to the collector with the monthly return on Form 1012 (page 43). Affidavits cannot include interest payments of different issues or different maturities, separate affidavits being required for each issue and each maturity.

In the case of a foreign item which is not accompanied by an ownership certificate and the owner of which is unknown, a like affidavit, and Form 1001-A, showing the name and address of the payee, should be executed by the first bank. For audit purposes, the Treasury Department will consider the payee to be the actual owner of the income.

Tax Exempt Bonds

Ownership certificates are not required in the collection of interest on obligations of the United States or of any state,

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territory, or any political subdivision thereof or of the District of Columbia, or on securities issued under the Federal Farm Loan Act of July 7, 1916.

While the bonds of the War Finance Corporation are exempt from normal tax, they are not obligations of the United States and the Treasury Department therefore requires that ownership certificate Form 1001 be executed when collecting interest thereon.

Withholding in 1918

In the case of payments made prior to February 25, 1919, where a withholding agent, pursuant to the Revenue Acts of 1916 and 1917, withheld only 2 per centum from the income of nonresident alien individuals, only such sum is required to be paid to the Government. As to payments made on and after February 25, 1919, tax shall be withheld at the rates prescribed by the Act of 1918.

In all cases where a withholding agent withheld tax pursuant to the Revenue Acts of 1916 and 1917, from the income of foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein, such withholding agent need return only the sum withheld to an amount not in excess of the aggregate sum required to be withheld by the terms of the Revenue Act of 1918. As to payments made to foreign corporations on and after February 25, 1919, tax shall be withheld at the rates prescribed by the Act of 1918.

On payments made prior to February 25, 1919, withholding as to foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein, was confined to interest on bonds of domestic and resident corporations and dividends on stock of domestic and resident corporations. The Revenue Act of 1918 repealed the provision requiring the withholding of tax on dividends on stocks of domestic and resident corporations, payable to foreign corporations, but extended withholding to miscellaneous fixed or determinable annual or periodical income.

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Release of Excess Tax Withheld

As the Revenue Act of 1918 does not provide for the withholding of tax in the case of corporate dividends, any tax so withheld since December 31, 1917, shall be released by the withholding agent and paid over to the corporation from which it was withheld, or its proper representative.

Where withholding agents have so released any excess of tax, an itemized statement showing the names, addresses, and amounts refunded should have been attached to the annual list return (Form 1013, page 45) in order to reconcile any discrepancy between the aggregate amount of tax returned as shown by the monthly list returns (Form 1012, page 43) and the aggregate amount as shown by the annual list return. If a bank or withholding agent has filed its annual list return without such supplementary information as to items thus released, an amended return should be prepared and filed with the collector, accompanied by an explanatory letter.

Withholding in the Case of Enemies

Payments made after October 6, 1917, to the Alien Property Custodian are in the same category as payments made to or for citizens or residents of the United States. Withholding at the source is accordingly not required, except in the case of interest payments on corporate bonds or other obligations containing a "tax-free" covenant.

Liability of Withholding Agent

Every withholding agent is made liable for tax required to be withheld at the source and is indemnified against the claims and demands of any individual, corporation, or partnership for the amount of any payments made in accordance with the law. If any tax required to be deducted and withheld is paid by the recipient of the income it shall not be recollected from the withholding agent and in cases in which the tax is so paid, no penalty shall be assessed or collected from the recipient of the income or the withholding agent for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

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Information at Source

Payments of Miscellaneous Income of $1,000 or More

All persons, including disbursing officers, employees of the United States, and fiduciaries, making payments to any individual citizen or resident of the United States, domestic partnership, personal service corporation, or fiduciary of fixed or determinable income of $1,000 or more in a taxable year, whether such total sum is made up of wages, salaries, commissions or compensation in any other form must render a report thereof on Form 1099 (page 41), accompanied by a letter of transmittal on Form 1096 (page 49), to the Commissioner of Internal Revenue for the preceding calendar year on or before March 15th.

Reports are not required in the following cases:

(1) Interest on the obligations of the United States, of states, territories, or political subdivisions thereof or of the District of Columbia, and compensation paid officers and employees by a state or political subdivision thereof for personal services;

(2) Bills paid for merchandise, telegrams, telephone, freight, storage, and similar charges;

(3) Amounts paid to employees for expenses incurred in business;

(4) Premiums paid to insurance companies;

(5) Annuities representing return of capital;

(6) Interest accrued on bank deposits if not credited;

(7) Payments of rent made to real estate agents or representatives, but agents or representatives are required to report payments to landlord or owner if they amount in the aggregate to $1,000 or more for the year;

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(8) Payments made by domestic establishments or foreign branch houses thereof to nonresident alien employees for services performed entirely in foreign countries;

(9) Interest on bonds of domestic and foreign corporations; (See Forms 1012 and 1096-A, pages 43 and 51);

(10) Salaries, wages, etc., paid to nonresident alien individuals and foreign corporations (See Form 1042, page 47).

Payments to Nonresident Alien Individuals and Corporations

All persons or organizations making payment of fixed or determinable annual or periodical income to nonresident alien individuals or foreign corporations not engaged in business in the United States and not having an office or place of business therein, must render a report therefor on Form 1098 (page 39) regardless of amount. These reports must be filed with the collector of internal revenue on or before March 1 of the year following that during which the payments were made, accompanying the annual return on Form 1042 (page 47).

Payments of Dividends

When directed by the Commissioner, either specially or by general regulation, every domestic or resident foreign corporation and every personal service corporation, shall render a return on Form 1097 of its payments of dividends and distributions to stockholders for such period as may be specified, stating the name and address of each stockholder, the number and class of shares owned by him, the date and the amount of each dividend paid to him, and when the surplus out of which it was paid was accumulated.

Brokers' Returns

Brokers, only when directed by the Commissioner, either specially or by general regulation, shall render a return on Form 1100 showing the names and addresses of their customers to whom payments were made or for whom business was transacted during the calendar year or for other specified period next preceding and giving the other information called for by the form.

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Interest on Bonds of Domestic or Resident Corporations

In the case of payments of interest, regardless of the amount, on bonds and similar obligations of domestic or resident foreign corporations, the original ownership certificates, when duly filed, shall constitute and be treated as returns of information (see Form 1000, page 23; Form 1001, page 25; Form 1001-A, page 27; Form 1001-B, page 29).

Foreign Items

The term "foreign item" means any dividend upon the stock of a nonresident foreign corporation or any item of interest on bonds of foreign countries or nonresident foreign corporations, whether or not such dividend or interest is paid in the United States or by check drawn on a domestic bank. If a foreign country or nonresident foreign corporation issuing bonds has appointed a paying agent in this country charged with the duty of paying the interest upon its bonds, such paying agent shall be the source of information. If such foreign country or foreign corporation has no such agent, then the last bank or collecting agent in this country shall be the source of information. In the case of dividends on the stock of a nonresident foreign corporation, however, the first bank or collecting agent accepting such item for collection shall be the source of information.

In the collection of foreign items certificate Form 1001-A should at all times be used, unless the bonds are owned by a citizen or resident of the United States or a resident partnership and contain a "tax-free" covenant clause, and the issuing corporation has a paying agent in the United States, in which case certificate Form 1000 should be used in order to obtain the benefit of the payment of the tax assumed by the debtor corporation. In the latter case, if personal exemption is claimed, certificate Form 1001-A should be filed.

If the owner of a foreign item is unknown, however, the procedure outlined on page 11 should be followed.

If such foreign bonds or stocks are owned by a nonresident alien individual, corporation, or partnership, certificate Form 1001-A may be executed on behalf of such owner by any re-

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sponsible bank or banker, either foreign or domestic, having knowledge of such ownership. It is not necessary that the name of the foreign owner be filled in on the form when executed by such bank or banker.

The original certificates of ownership filed in connection with the collection of foreign items, shall constitute and be treated as reports of information. The use of substitute certificates Form 1058 and Form 1059 is not permitted in connection with foreign items.

Disclosure of Actual Ownership of Stock

The regulations provide that dividends on stock of domestic corporations or resident foreign corporations are prima facie income of the record owner of the stock and such record owner will be liable for any tax thereon, unless a disclosure of the actual ownership is made to the Commissioner of Internal Revenue. If the record owner is a citizen or resident of the United States or a resident corporation, and the actual owner is a nonresident alien, the actual ownership should be disclosed on Form 1087 (page 37).

In all cases where the actual owner is a nonresident alien individual and the record owner is a person in the United States, the record owner will be considered, for tax purposes, to have the receipt, custody, control and disposal of the dividend income and will be required to make return for the actual owner on Form 1040, and pay the tax found by such return to be due.

Where bearer certificates with coupons attached are issued against stock of domestic corporations and such bearer certificates are owned by nonresident aliens, certificate Form 1087, signed by the holders of the bearer certificates should be filed.

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Preparation of Ownership Certificates

The owners of bonds or other obligations issued by domestic or resident corporations, whether or not such bonds contain a "tax-free" covenant, when presenting interest coupons for payment, shall file a separate certificate of ownership for each issue of bonds and for each maturity of the same issue, showing:

(a) name and address of the debtor corporation;

(b) nature of the obligation;

(c) amount of interest and its due date;

(d) amount of any tax withheld.

The spaces "due date" and "date paid" contained in the new forms of ownership certificates do not relate to the dates when the bonds themselves mature, but to payments of interest.

Under existing Treasury regulations, payments should be refused unless all information called for on ownership certificates is complete.

Execution of Ownership Certificates by Fiduciaries and Joint Owners

When fiduciaries have the control and custody of more than one estate or trust and such estates or trusts have as assets bonds of corporations and other securities, a certificate of ownership shall be executed for each estate or trust, regardless of the fact that the bonds are of the same issue.

Under the heading "Owner of Bonds" the name and title of the fiduciary should be entered, together with the name of the individual, estate, or trust for whom he acts.

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If bonds are owned jointly by several persons, a separate ownership certificate must be executed on behalf of each of the owners.

Charitable and Other Tax-Exempt Foreign Corporations

When collecting interest on bonds of domestic or resident corporations, charitable and other exempt foreign organizations should use Form 1001, whether or not the bonds contain a "tax-free" covenant. The words "Exempt Organization" should be written across the face of the certificate.

Interest on Registered Bonds

Where the bondholder files no ownership certificate in the case of payments of interest on registered bonds, the withholding agent shall make out a certificate in each instance on Form 1000, or on Form 1001, as the case may be.

Coupons Purchased Abroad

In case coupons detached from bonds issued by a domestic corporation are purchased abroad, the purchaser is prima facie held to be the recipient of income. For this reason, ownership certificates should be secured from the original owners of the bonds in order that the tax may be withheld under the provisions of the 1918 Revenue Law. (See also "Owners Unknown," page 10).

Basis of Returns

All returns of withholding and information must be filed on the basis of the calendar year and not on the basis of a fiscal year other than the calendar year.

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Ownership

February

Item	Individual, Citizen or Resident of U. S.	Individual Nonresident Alien	Fiduciary Resident	Fiduciary Nonresident Alien
DOMESTIC BONDS (Tax Free Covenant)	*1000 Line 1	†1000 Line 3	*1000 Line 1	†1000 Line 3
DOMESTIC BONDS (No Tax Free Covenant)	1001 Line 2	1000 Line 3	1001 Line 2	1000 Line 3
FOREIGN BONDS (Tax Free Covenant) No Paying Agent in U. S.	1001-A Line 1	1001-A Line 4	1001-A Line 1	1001-A Line 4
FOREIGN BONDS (Tax Free Covenant) Paying Agent in U. S.	**1000 Line 1	1001-A Line 4	**1000 Line 1	1001-A Line 4
FOREIGN BONDS (No Tax Free Covenant)	1001-A Line 1	1001-A Line 4	1001-A Line 1	1001-A Line 4
FOREIGN DIVIDENDS	1001-A Line 1	1001-A Line 4	1001-A Line 1	1001-A Line 4

*If exemption is claimed Form 1001, Line 1 (See page 25).

†If exemption is claimed Form 1001-B may be filed after December 31, but not later than February 1 (See page 29).

**If exemption is claimed Form 1001-A, Line 1 (See page 27).

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Certificate Chart

1. 1920

Partnership Domestic or Resident	Partnership Nonresident Alien	Corporation Domestic	Foreign Corporation with Office in U. S.	Foreign Corporation without Office in U. S.	Unknown
1000 Line 2	1000 Line 4	1001 Line 4	1001 Line 6	1000 Line 5	1000 Line 6
1001 Line 3	1001 Line 5	1001 Line 4	1001 Line 6	1000 Line 5	1000 Line 6
1001-A Line 2	1001-A Line 5	1001-A Line 3	1001-A Line 6	1001-A Line 6	1001-A (See pg 11)
1000 Line 2	1001-A Line 5	1001-A Line 3	1001-A Line 6	1001-A Line 6	1001-A (See pg 11)
1001-A Line 2	1001-A Line 5	1001- A Line 3	1001-A Line 6	1001-A Line 6	1001-A (See pg 11)
1001-A Line 2	1001-A Line 5	1001-A Line 3	1001-A Line 6	1001-A Line 6	1001-A (See pg 11)

Numbers refer to Ownership Certificate Forms.

Ownership certificates need not be filed in collecting interest on obligations of the United States and State and Municipal issues.

Foreign governments, when collecting interest on bonds of domestic and resident corporations, must file certificate Form 1001.

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Form 1000.
Revised May, 1919.
U. S. Internal Revenue.

OWNERSHIP CERTIFICATE—TAX TO BE PAID AT SOURCE

INTEREST ON BONDS AND OTHER SIMILAR OBLIGATIONS OF DOMESTIC AND RESIDENT CORPORATIONS

NAMES MUST BE PRINTED OR WRITTEN PLAINLY.

DEBTOR ORGANIZATION

NAME

ADDRESS

OWNER OF BONDS (Give name in full)

NAME

STREET ADDRESS

POST OFFICE

Due date ..... Date paid .....

If owner is an individual, is he married? .... If not, is he head of a family? .....

I certify that the owner of the bonds from which the interest entered herein was derived falls within the class of persons or organizations opposite which such interest is entered.

SIGNATURE OF OWNER OR AGENT

.....

Address of agent. .....

.....

SEE INSTRUCTIONS ON FORM 1012

Tax should be withheld at rate indicated. 2—8829

OWNER	INTEREST ON BONDS AND SIMILAR OBLIGATIONS						TAX WITHHELD	
	With tax-free-covenant clauses			Without tax-free-covenant clauses				
Citizen or Resident of U. S.: 1. Individual or fiduciary (Personal exemption not claimed)	2% $			(Not subject to withholding Use Form 1001)			$	
2. Partnership	2% $			(Not subject to withholding Use Form 1001)			$	
Nonresident Alien: 3. Individual or fiduciary	2% $			8% $			$	
4. Partnership	2% $			(Not subject to withholding Use Form 1001)			$	
5. Corporation having no office or place of business in U. S.	2% $			10% $			$	
6. Unknown	2% $			8% $			$	

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Form 1000

Ownership Certificate

Tax to be Paid at Source

Form 1000 must be filed by

(1) Citizens or residents (individuals and fiduciaries), not claiming exemption;

(2) Partnerships (resident or nonresident);

(3) Personal service corporations,*

when collecting interest on bonds or other similar obligations of domestic or resident corporations, or foreign corporations having a paying agent in the United States, which contain a "tax-free" covenant, and by

(1) Nonresident alien individuals;

(2) Nonresident alien fiduciaries;

(3) Foreign corporations having no office or place of business in the United States;

(4) First collecting bank when owner of the bond is unknown,

when collecting interest on bonds or other similar obligations of domestic or resident corporations whether or not containing a "tax-free" covenant.

Bonds are known as "tax-free" covenant bonds when they contain a provision by which the corporation agrees to pay any portion of the tax imposed by the income tax law, upon the owner of the bonds, or to reimburse the owner of the bonds for any portion of the tax which he may be obliged to pay, or to pay the interest without deduction for any tax which the corporation may be required or permitted to pay thereon or to retain therefrom under any law of the United States. The filing of this certificate in the collection of interest on "tax-free" covenant bonds serves as notice to the corporation issuing the bonds that the owner is subject to income tax and that the corporation is therefore liable for the payment of the normal tax to the extent of 2 per centum of the amount of the face value of the coupons deposited, in accordance with the covenant in the indenture under which the bonds are issued.

All certificates on Form 1000 must be filed with the collector for the district in which the withholding agent is located, on or before the 20th day of the month succeeding that for which made, accompanied by a return on Form 1012.

*See page 6.

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Form 1001
Revised Jan., 1920
U. S. Internal Revenue

OWNERSHIP CERTIFICATE—TAX NOT TO BE PAID AT SOURCE

INTEREST ON BONDS AND OTHER SIMILAR OBLIGATIONS OF DOMESTIC AND RESIDENT CORPORATIONS

NAMES MUST BE PRINTED OR WRITTEN PLAINLY

DEBTOR ORGANIZATION

NAME .....

STREET .....

CITY ..... STATE .....

Due date ..... Date paid .....

Issue of Bonds: .....

I certify that the owner of the bonds or other similar obligations from which the interest entered herein was derived falls within the class of persons or organizations opposite which the amount of such interest is entered and is entitled to such interest without deduction of tax.

SIGNATURE OF OWNER OR AGENT .....

Address of agent .....

.....

—8598

SEE INSTRUCTIONS ON FORM 1006 A

OWNER OF BONDS (Give name in full)

NAME .....

STREET .....

CITY ..... STATE .....

OWNER	INTEREST ON BONDS AND SIMILAR OBLIGATIONS	
	With tax-free covenant clause	Without tax-free covenant clause
Citizen or Resident of U. S.: 1. Individual or fiduciary (Personal exemption claimed)*	$	X X X X X
2. Individual or fiduciary (Not subject to withholding)	X X X X X X	$
3. Partnership	(Tax to be withheld) Use Form 1006	$
4. Corporation	$	$
Nonresident Alien: 5. Partnership	(Tax to be withheld) Use Form 1006	$
6. Corporation having an office or place of business in U. S.	$	$
7. Foreign government	$	$

* The exemption claimed during a taxable year by ownership certificates must not exceed the personal exemption allowed by law. If exemption is claimed in this manner on any interest received, credit for tax paid at source must not be claimed with respect to such interest on the taxpayer's individual income tax return.

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Form 1001

Ownership Certificate

Tax Not to be Paid at Source

Form 1001 must be filed by

(1) Citizens or residents (individuals and fiduciaries);

(2) Partnerships (resident or nonresident),

when collecting interest on bonds or other similar obligations of domestic or resident corporations which do not contain a "tax-free" covenant, and by

(1) Domestic and resident corporations;

(2) Foreign corporations having an office or place of business in the United States,

when collecting interest on bonds or other similar obligations of domestic or resident corporations, whether or not such bonds contain a "tax-free" covenant.

Foreign governments or foreign corporations exempt from income tax, when collecting interest on bonds of domestic or resident corporations, whether or not containing a "tax-free" covenant, should execute Form 1001, entering the amount of interest due on Line 7.

Form 1001 should also be filed by citizens or residents (individuals and fiduciaries) when collecting interest on bonds or other similar obligations of domestic or resident corporations which contain a "tax-free" covenant clause, if personal exemption is claimed. The exemption so claimed during a taxable year must not exceed the personal exemption of the taxpayer allowed by law. If exemption is claimed in this manner on any interest received, credit for tax paid at source must not be claimed with respect to such interest on the individual income tax return of the owner of the bonds.

Form 1001 should not be used by the owner of "tax-free" covenant bonds if his net income exceeds his personal exemption, unless he wishes to relieve the debtor corporation from the payment of the tax,

All certificates on Form 1001 must be filed with the Commissioner of Internal Revenue (Sorting Division), Washington, D. C., on or before the 20th day of the month succeeding that for which made, accompanied by a return on Form 1096-A.

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FORM 1001 A.
Revised February, 1919.
U. S. INTERNAL REVENUE.

OWNERSHIP CERTIFICATE—TAX NOT TO BE PAID AT SOURCE

DIVIDENDS ON STOCK OF FOREIGN CORPORATIONS AND INTEREST ON BONDS OF FOREIGN COUNTRIES AND FOREIGN CORPORATIONS

NAMES MUST BE PRINTED OR WRITTEN PLAINLY

DEBTOR ORGANIZATION

NAME.....

ADDRESS.....

.....

Due date..... Date paid.....

If owner is an individual, is he married?..... If not, is he head of a family?.....

I certify that the owner of the bonds or stock on which the interest or dividend entered herein was derived falls within the class of persons or organizations opposite which the amount of such interest or dividend is entered and is entitled to such interest or dividend without deduction of tax.

SIGNATURE OF OWNER OR AGENT

.....

ADDRESS OF AGENT.

.....

.....

SEE INSTRUCTIONS ON FORM 1096 A.

OWNER OF BONDS OR STOCKS (Give name in full)

NAME.....

STREET ADDRESS.....

POST OFFICE.....

OWNER.	INTEREST ON BONDS.			DIVIDENDS.		
Citizen or Resident of U. S.:						
1. Individual or fiduciary	$			$		
2. Partnership	$			$		
3. Corporation	$			$		
Nonresident Alien:						
4. Individual or fiduciary	$			$		
5. Partnership	$			$		
6. Corporation	$			$		

2—6163

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Form 1001-A

Ownership Certificate

Tax Not to be Paid at Source

Form 1001-A is to be used by owners of bonds of foreign countries or owners of bonds or stocks of foreign corporations. Where bonds of a foreign country or foreign corporation, having a paying agent in this country, contain a "tax-free" covenant, Form 1000 shall be used when the bonds are owned by a citizen or resident of the United States, unless the owner desires to claim exemption, in which case Form 1001-A shall be used. If Form 1000 is used as above provided, the paying agent is required to pay the tax of 2 per centum upon the interest on such bonds, in accordance with the terms of the "tax-free" covenant.

If foreign bonds or stocks are owned by a nonresident alien individual, fiduciary, partnership, or corporation, certificate Form 1001-A may be executed on behalf of such owner by any responsible bank or banker, either foreign or domestic, having knowledge of such ownership. It is not necessary that the name of the foreign owner be filled in on the form when so executed, but the due date and the date paid must be given.

In the case of interest on bonds, if the foreign country or foreign corporation has appointed a paying agent in this country, paying the interest on its bonds, such paying agent shall be the source of information. In such case, ownership certificates should accompany the coupons to the paying agent. If there is no paying agent in the United States, the last bank or collecting agent in this country shall be the source of information and in such case, ownership certificate should be detached by such bank.

In the case of dividends on stock of foreign corporations, the first bank or agent accepting such items for collection shall be the source of information. In this case, the ownership certificate shall be detached by the first collecting bank or agent and the check stamped "Certificate detached and information furnished by . . . . . ," with its name and address.

All certificates on Form 1001-A must be filed with the Commissioner of Internal Revenue (Sorting Division), Washington, D. C., on or before the 20th day of the month succeeding that for which made, accompanied by a return on Form 1096-A.

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TREASURY DEPARTMENT
U. S. Internal Revenue
Form 1001 (Revised, Jan

This form will not be accepted unless all information called for is furnished.

STATEMENT OF INCOME RECEIVED BY NONRESIDENT ALIEN FROM SOURCES WITHIN UNITED STATES

PERSONAL EXEMPTION CLAIMED.

To be filed with withholding agent by nonresident alien individual owning bonds of a domestic corporation which contain a tax-free covenant clause. The execution of this certificate does not relieve the bond owner from filing ownership certificate required by the regulations.

NAMES MUST BE PRINTED OR WRITTEN PLAINLY.

DEBTOR ORGANIZATION.	OWNER OF BONDS.
Name	Name
Street	Street
City State	City State
	Subject of

This is to certify that the owner of the above-described bonds is a nonresident alien as to the United States and is a subject of the country as stated above, and is entitled to personal exemption and credit for dependents in accordance with paragraphs (*f*) and (*d*), Section 216 of the Revenue Act of 1918, and Article 397, Regulations 45.

Signature or Owner on Article.

Address of Agent.

Bond interest received during calendar year with respect to tax-free covenant bonds issued by above-named corporation $

All other income from sources in United States $

Total $

Personal exemption $

Credit for dependents $

Total $

Citizens or subjects of the countries enumerated in Class (*c*) of Article 397, Regulations 45, as amended, will be allowed for the purpose of the normal tax the following credits:

In the case of a single person, a personal exemption of $1,000, or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $2,000. A husband and wife living together shall receive but one personal exemption of $2,000 against their aggregate net incomes; and in case they make separate returns, the personal exemption of $2,000 may be taken by either or divided between them;

$200 for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer, if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective.

Citizens or subjects of the countries enumerated in Class (*b*) of Article 397 will be allowed the benefit of the personal exemption but no credit for dependents. Citizens or subjects of the countries enumerated in Class (*c*) of Article 397 will not be permitted to claim the benefit of personal exemption or credit for dependents and should disregard any on this form.

TO BE FILLED IN BY WITHHOLDING AGENT.

District in which return Form 1013 is filed

Amount of tax required to be withheld at source as shown by Form 1013, for 1919, $

To be reduced on account of personal exemption claimed as indicated by this certificate, the items appearing on the following monthly returns, Form 1013:

Month Page Amount of tax. $

Month Page Amount of tax.

Month Page Amount of tax.

Month Page Amount of tax.

Total $

Name of withholding agent

Address

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Form 1001-B

In case a nonresident alien is entitled to personal exemption and credit for dependents in accordance with paragraphs (c) and (d), Section 216 of the Revenue Act of 1918 and Article 307, Regulations 45, as amended (see page 7), and his gross income from sources in the United States, (including bond interest) does not exceed his personal exemption and credit for dependents, a certificate on Form 1001-B should be executed and filed with the withholding agent, if any part of the gross income is derived from interest on bonds of a domestic corporation, which contain a "tax-free" covenant clause.

The execution of this certificate does not relieve the bond owner from filing ownership certificates required by the regulations.

All certificates Form 1001-B may be filed with the withholding agent at the end of the calendar year, but not later than February 1 of the succeeding year, and all such certificates should be attached to the annual list return Form 1013.

The amount of tax due from the withholding agent as shown on Form 1013 may be reduced by 2 per centum of the aggregate amount of the interest payments made to the nonresident alien upon "tax-free" covenant bonds during the calendar year and the amount of tax represented by the certificates, payment of which was assumed on the monthly list return Form 1012, will not be included in the assessment against the withholding agent.

In case tax in excess of a nonresident alien's tax liability has been withheld from interest upon bonds which do not contain a "tax-free" covenant clause, the nonresident alien should file or cause to be filed with the collector of internal revenue, a return of his gross income from all sources within the United States, accompanied by a claim for refund on Form 46.

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Form 1058.
Revised February, 1919.
U. S. Internal Revenue.

SUBSTITUTE CERTIFICATE—TAX NOT TO BE PAID AT SOURCE

INTEREST ON BONDS AND OTHER SIMILAR OBLIGATIONS OF DOMESTIC AND RESIDENT CORPORATIONS

DEBTOR ORGANIZATION

NAME .....

ADDRESS .....

NUMBER GIVEN ORIGINAL CERTIFICATE FORM 1001 .....

(Date of maturity of interest.)	(Date paid.)

I certify that the owner of the bonds from which were detached the accompanying interest coupons has filed a certificate of ownership, Form 1001, duly executed as required by Treasury Regulations, and that under the provisions of the Income Tax law, said interest is exempt from the withholding of tax at the source, or that exemption was claimed as stated herein; and I hereby promise to forward the said certificate to the Commissioner of Internal Revenue at Washington, D. C.

Name of bank or collecting agent .....

Name, address, and title of the person authorized to sign .....

SEE INSTRUCTIONS ON FORM 1096 A.

3—6304

OWNER. (CITIZEN OR RESIDENT OF U. S.)	INTEREST ON BONDS. With tax-free covenant clauses.			Without tax-free covenant clauses.		
1. Individual or fiduciary (Personal exemption claimed)	$			x	x x x	x x
2. Individual or fiduciary (Not subject to withholding)	$ x	x x x	x x			
3. Partnership	(Tax to be withheld) Use Form 1039					
4. Corporation	$					

This certificate should be attached to interest coupons by the collecting agent as a substitute for the owner's certificate Form 1001.

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Form 1058

Substitute Certificate

Tax Not to be Paid at Source

Resident collecting agents and responsible banks and bankers receiving for collection interest coupons from

(a) bonds and other similar obligations of domestic and resident corporations not containing a "tax-free" covenant owned by
   (1) citizens or residents (individuals and fiduciaries);
   (2) resident partnerships;
   (3) domestic and resident corporations;

(b) bonds or other similar obligations containing a "tax-free" covenant owned by
   (1) citizens and residents (individuals and fiduciaries), claiming exemption;
   (2) domestic and resident corporations,

with ownership certificates Form 1001 attached, may detach the original certificates and forward them directly to the Commissioner of Internal Revenue, providing such collecting agent shall substitute for such certificates, its own certificates on Form 1058, keeping a complete record of each transaction, showing the serial number of each item received; date received; name and address of person from whom received; name of debtor corporation; class of bonds from which coupons were cut and the face amount of coupons.

For the purpose of identification, the substitute certificates should be numbered consecutively, reverting to the numeral 1 at beginning of each calendar year, and corresponding numbers noted on the original certificates of ownership. The use of substitute certificates is not permitted, however, in the case of ownership certificates presented with coupons for collection by nonresident alien individuals, partnerships, or corporations.

The original certificates should be endorsed as follows:

"Owner's Certificate No.....

.....
(Name of bank or collecting agent)

.....19....
(Give date of certificate)

"The counterpart of the within certificate bearing like number was attached to the coupons within mentioned for delivery, to the debtor or withholding agent, by whom the coupons are payable."

The debtor corporation or its duly authorised paying agent shall forward all certificates Form 1058 to the Commissioner of Internal Revenue with the monthly list return Form 1096-A.

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Form 1059.
Revised February, 1919.
U. S. INTERNAL REVENUE.

SUBSTITUTE CERTIFICATE—TAX TO BE PAID AT SOURCE

INTEREST ON BONDS AND OTHER SIMILAR OBLIGATIONS OF DOMESTIC AND RESIDENT CORPORATIONS

DEBTOR ORGANIZATION

NAME .....

ADDRESS .....

NUMBER GIVEN ORIGINAL CERTIFICATE FORM 1000 .....

Date of maturity of interest.	Date paid.

I certify that the owner of the bonds from which were detached the accompanying interest coupons has filed a certificate of ownership, Form 1000, duly executed as required by Treasury Regulations, and I hereby promise to forward the said certificate to the Commissioner of Internal Revenue at Washington, D. C.

Name of bank or collecting agent .....

Name, address, and title of the person authorized to sign .....

SEE INSTRUCTIONS ON FORM 1012.

OWNER. (CITIZEN OR RESIDENT OF U. S.)	INTEREST ON BONDS WITH TAX-FREE-COVENANT CLAUSES.	TAX WITHHELD.
1. Individual or fiduciary (Personal exemption not claimed)	$	$
2. Partnership	$	$

This certificate should be attached to interest coupons by the collecting agent as a substitute for the owner's certificate Form 1000. 2—6260

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Form 1059

Substitute Certificate

Tax to be Paid at Source

Form 1059 may be substituted in lieu of Form 1000 by collecting agents and responsible banks and bankers receiving for collection, interest coupons on bonds and other similar obligations of domestic or resident corporations containing a "tax-free" covenant, when owned by

(1) citizens or residents (individuals and fiduciaries) not claiming exemption;

(2) resident partnerships;

(3) personal service corporations.*

The requirements governing its execution are similar to those set forth on page 31, in connection with Form 1058.

Forms 1000 when detached by collecting agents shall be forwarded directly to the Commissioner of Internal Revenue. Forms 1059 should be forwarded to the Commissioner of Internal Revenue by the debtor corporation or withholding agent with Return Form 1012.

*See page 6.

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FORM 1078
Revised June, 1919
S. INTERNAL REVENUE

CERTIFICATE OF ALIEN CLAIMING RESIDENCE IN THE UNITED STATES

(To be filed with withholding agent by alien residing in the United States, for the purpose of claiming the benefit of such residence for income tax purposes)

THIS CERTIFICATE HAS NO EFFECT ON CITIZENSHIP

EMPLOYER	EMPLOYEE
NAME.....	NAME.....
ADDRESS.....	STREET ADDRESS.....
.....	POST OFFICE.....

I HEREBY declare that I am a citizen or subject of .....; that I arrived in the United States on or about .....; that I am living in the United States and have no definite intention as to when (if at all) I will make another country my home; that the address in the United States where any notices relative to income tax may be sent or mailed to me is as stated above.

Sworn to and subscribed before me this

..... day of ....., 19.....

(Signed) .....

.....

.....
(Official capacity.)

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Form 1078

Certificate of Alien Claiming Residence in the United States

Form 1078 is to be filed with withholding agents by aliens residing in the United States who desire to establish their status as resident aliens for the purpose of claiming the benefit of such residence for income tax purposes.

An alien living in the United States who is not a mere transient is a resident of the United States for purposes of the income tax. Whether he is a transient or not is determined by his intentions with regard to his stay.

When certificate Form 1078 is filed with an employer, an alien employee may be treated as a resident of the United States with respect to withholding income tax at the source and it is not necessary for the employer to secure from the alien employee a new certificate for each year. Aliens employed in the United States are prima facie regarded as nonresidents, but this presumption is overcome if the alien files with the employer Form 1078 or an equivalent certificate, giving his residence. The employer may rely on such certificate, unless the statement was false, and he has reasonable cause to believe it was false, until the alien ceases to be a resident.

If an alien has been living in the United States for as long as one year immediately prior to the time he entered the employment of the withholding agent, or if he has been regularly employed by an individual resident in the United States or by a resident corporation in the same city or county for as long as three months immediately prior to any payment by the employer, he may be treated as a resident, provided no facts are known to the employer that he is, in fact, a transient.

Where the status of an alien changes during the year the status which exists at the end of the taxable year governs his right to exemption as to the whole year. If an employer has withheld wages from a nonresident alien during part of a year and thereafter the employee became a resident (before the employer has paid over to the United States the amount withheld) the employer is authorized, upon receiving proof of the change, to refund to the employee the amount so withheld.

Every withholding agent with whom certificates on Form 1078 are filed is required to make a record thereof and file the certificates with the Commissioner of Internal Revenue (Sorting Division), Washington, D. C., not later than the 20th day of the month succeeding that during which such certificates were received, accompanied by a letter of transmittal.

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Form 1067. Revised April, 1919.

TREASURY DEPARTMENT, INTERNAL REVENUE—INCOME TAX.
Ed 200,000—F C., Apr. 21-19.

Ownership Certificate—DISCLOSING ACTUAL OWNER OF STOCK.

(For use of Foreign Principal to disclose actual ownership of stock of domestic corporation registered in name of representative in United States.)

RECORD OWNER.	ACTUAL OWNER.
NAME	NAME .....
ADDRESS	ADDRESS .....

Number of shares stock owned ..... Class of stock (common, preferred, etc.) .....

.....
(Issuing corporation.)

.....
(Address.)

I (we) hereby declare that I am (we are) the actual owner of the above-described stock or that the record owner of said stock holds it for my (our) account and the actual owner is as stated above; that I am (we are) or the actual owner is (are) nonresident alien as to the United States; that the record owner of said stock is correctly listed above and that said record owner is the representative in the United States of the undersigned with respect to said stock; and that all the information given herein is true and correct.

Date, ..., 19..... .....
(Signature of actual owner or representative.)

.....
(Full post-office address of actual owner or representative.)

By .....
(If organization signature of official authorized to sign and official position.)

2—877

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Form 1087

Ownership Certificate—Disclosing Actual Owner of Stock

Form 1087 is used for the purpose of disclosing the actual ownership of stock of domestic corporations registered in the name of a representative in the United States, when the actual owner is a nonresident alien. Unless this certificate is filed, the record holder of the stock is considered the owner of the dividends, for income tax purposes, and required to pay tax thereon accordingly. The certificate should be executed by the actual owner or his agent.

The certificate once filed disclosing the actual owner will be sufficient until ownership changes, when it will be necessary to disclose the actual owner by a new certificate.

In all cases where the actual owner is a nonresident alien individual and the record owner is a person in the United States, the record owner will be considered for tax purposes to have the receipt, custody, control and disposal of the dividend income, and will be required to make return for the actual owner, regardless of the amount of the income, and to pay any surtax found by such return to be due.

Certificates have not been provided for disclosing ownership where the actual owner is a citizen or resident of the United States, although the regulations do not confine such disclosure to cases in which the actual owner is a nonresident alien (Article 405, Reg. 45).

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Form 1096.
Revised January, 1920.
U. S. Internal Revenue.

REPORT OF INCOME PAID TO NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS DURING THE CALENDAR YEAR 1919

TAX TO BE PAID AT SOURCE

NAMES MUST BE PRINTED OR WRITTEN PLAINLY

PERSON, FIRM, OR CORPORATION PAYING INCOME.

NAME .....

STREET .....

CITY ....., STATE .....

NONRESIDENT ALIEN INDIVIDUAL OR FOREIGN CORPORATION TO WHOM PAID.

NAME .....

STREET .....

CITY ....., STATE .....

INSTRUCTIONS.

One of these forms must be filled in for each nonresident alien individual or foreign corporation (not engaged in business within the United States and not having any office or place of business therein) to whom interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual or periodical gains, profits, and income were paid during the year 1919 by any individual, corporation, partnership, fiduciary, employer, or officer or employee of the United States having the control, custody, disposal, or payment of income as above described.

These reports covering interest, rent, salaries, etc., must be forwarded to the Collector of Internal Revenue with a return on Form 1042, so that they will reach his office not later than March 1, 1920. See instructions on that form.

2—4187

KIND OF INCOME.	AMOUNT PAID.		TAX WITHHELD.	
Salaries, wages, commissions, etc.	$		$	
Rent				
Interest on notes, mortgages, etc.				
Premiums, annuities				

On the blank line above enter the kind and amount of any other fixed or determinable annual or periodical gains, profits, and income paid and amount of tax withheld.

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Form 1098

Report of Income Paid to Nonresident Alien Individuals and Foreign Corporations During Calendar Year

Form 1098 must be prepared and filed for each nonresident alien individual or foreign corporation not engaged in business, and not having an office in the United States, to whom interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual or periodical gains, profits and income were paid during the year, except payments of interest on bonds and dividends on stock of domestic and resident corporations.

These reports must be made by the individual, partnership, corporation, or other person making any of the payments above described, and must be filed with the collector of internal revenue for the district in which the principal place of business of the withholding agent is located, on or before March 1 of the year following that during which the payments were made, accompanied by Form 1042.

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Furnished by Guaranty Trust Company of New York

TREASURY DEPARTMENT
Bureau Internal Revenue
Form 1099

REPORT OF INCOME OF $1,000 OR MORE PAID DURING THE CALENDAR YEAR 1919

(RETURNS FOR FISCAL YEAR CAN NOT BE ACCEPTED)

NAMES MUST BE PRINTED OR WRITTEN PLAINLY

SALARIES, WAGES, RENT, INTEREST, OR OTHER FIXED OR DETERMINABLE GAINS, PROFITS, AND INCOME

BY WHOM PAID

NAME.....

STREET.....

CITY..... STATE.....

TO WHOM PAID

NAME.....

STREET.....

CITY..... STATE.....

INSTRUCTIONS

One of these forms must be filled in for each person, partnership, or fiduciary to whom income, as described on this form, was paid during the calendar year 1919. The name and business address of the person or organization making the payments should be entered under the heading "By whom paid" and the name and home address (if an individual) or business address (if an organization) of the one to whom the income was paid should be entered under the heading "To whom paid."

These forms must be forwarded with return Form 1096 so as to reach the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., on or before March 15, 1920.

Do not report on this form dividends on stock, interest on bonds of domestic or foreign corporations, or interest on bonds and other obligations of the United States or foreign countries. For further instructions see Form 1096.

DENOTE BY CHECKING STATUS OF PAYEE { INDIVIDUAL / PARTNERSHIP. / FIDUCIARY.

KIND OF INCOME PAID	AMOUNT		
Salaries, wages, fees, commissions, etc.	$.....	.....	.....
Rent	$.....	.....	.....
Interest on notes, mortgages, etc.	$.....	.....	.....
Premiums and annuities	$.....	.....	.....
.....	$.....	.....	.....

On the blank line above enter the kind and amount of any other fixed or determinable gains, profits, and income except as noted in instructions. e2—8578

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Form 1099

Report of Income of $1,000 or More Paid During Calendar Year

Form 1099 must be prepared for each individual citizen or resident of the United States, domestic partnership, personal service corporation or fiduciary to whom salaries, wages, rent, interest or other fixed or determinable gains, profits and income of $1,000 or more were paid during the year. The name and business address of the person or organization making the payment and the name and home address (if an individual) or business address (if an organization) of the payee of the income, should be entered on the form.

Partnerships and personal service corporations shall prepare reports on Form 1099 for each member of the partnership or personal service corporation, and fiduciaries, for each beneficiary of the estate or trust, showing in each case the distributive share of the member or beneficiary, whether or not the income is actually distributed. The words "Partnership," "Personal Service Corporation," or "Fiduciary," as the case may be, should be entered on the blank line of the form under "Kind of income paid."

This form should also be executed covering payments of salaries to officers of an organization.

Forms 1099 must be filed with the Commissioner of Internal Revenue (Sorting Section), Washington, D. C., on or before March 15 of the year following that during which the payments were made, by the person or organization making them, accompanied by Form 1096 on which should be indicated the number of reports on Form 1099 and the total amount of payments made.

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Form 1042—Revised February, 1919—United States Internal Revenue Service

MONTHLY RETURN OF NORMAL INCOME TAX TO BE PAID AT SOURCE

INTEREST ON BONDS AND OTHER SIMILAR OBLIGATIONS OF DOMESTIC AND RESIDENT CORPORATIONS AND FOREIGN CORPORATIONS HAVING A PAYING AGENT IN THE UNITED STATES

FOR MONTH OF _____, 1919

THIS RETURN, IN DUPLICATE, ACCOMPANIED BY CHECK OR DRAFT OR CASH FOR THE AMOUNT OF TAX DUE, IS TO BE FILED WITH THE COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT IN WHICH THE WITHHOLDING AGENT IS LOCATED OR OR BEFORE THE 10TH DAY OF THE MONTH SUCCEEDING THAT FOR WHICH MADE

_____ (Name of debtor organization.)

_____ (Full post-office address.)

_____ (Name of withholding agent.)

_____ (Full post-office address.)

Date received

INSTRUCTIONS

If debtor organization makes its own withholding return, no entries need be made on lines provided above for name and address of withholding agent.

A return on this form must be made to cover the following classes of payments:

1. *Interest on bonds with tax-free-covenant clauses* paid to citizens and residents of the United States (individuals and fiduciaries) not claiming personal exemption, to domestic and resident partnerships, to nonresident alien individuals or fiduciaries, to foreign partnerships, and to foreign corporations having no office or place of business in the United States. A normal tax of 2 per centum is required to be withheld and paid at source in such cases.
2. *Interest on bonds without tax-free-covenant clauses:*
   (a) If paid to a nonresident alien individual, a normal tax of 8 per centum is required to be withheld and paid at source.
   (b) If paid to a foreign corporation having no office or place of business in the United States, a normal tax of 10 per centum is required to be withheld and paid at source.

A certificate on Form 1000 should accompany this return for every payment entered hereon.

In the absence of ownership certificates covering registered bonds owned by a person or organization falling within the classes named above, the debtor corporation shall prepare reports on Form 1000. When so used the forms need not be signed.

In the case of payments of interest on tax-free-covenant bonds to citizens and residents of the United States (individuals and fiduciaries) and to domestic and resident partnerships, resident collecting agents, and responsible banks and bankers receiving interest coupons for collection may detach certificate Form 1000 and forward it directly to the Commissioner of Internal Revenue provided certificate Form 1000 (revised) is substituted for the certificate detached. Substitute certificates Form 1000 should be listed by the debtor corporation on this return, the serial number given the original certificate being entered in the column "Name of Payee."

If coupons are received not accompanied by certificates of ownership, the first bank receiving such coupons will require of the payee an affidavit showing the following:

(a) Name and address of payee, (b) name and address of debtor corporation, (c) date of maturity of interest, (d) name and address of person from whom the coupons were received, (e) amount of interest and (f) a statement that owner of bonds is unknown to him.

This affidavit shall be forwarded to the Commissioner of Internal Revenue with a return on this form. The first bank shall prepare Form 1000, crossing out "owner" and inserting "payee," entering the amount of interest, due date, and date paid in the proper spaces and stamping or writing across the face of the certificate, "Affidavit furnished (insert name of bank)."

If bonds are owned jointly, separate certificates should be made by or for each joint owner. Fiduciaries must enter on the certificate under "owner of bonds" the name of estate, trust, or beneficiary on behalf of whom the exemption is claimed.

I CERTIFY that the following is a true and complete return of all payments of classes 1, 2(a), and 2(b) described above made, and of the amount of tax withheld during the month stated above by the above-named organization, the several items being evidenced by certificates listed below and inclosed herewith:

Class.	Interest Paid.			Tax Withheld.		
1	$			$		
2(a)						
2(b)						
Totals	$			$		

_____ (Signature.)

_____ (Capacity in which acting.)

_____ (Address in full.)

Name of Payee.	Street and Number, Post Office and State.	Amount Paid.			Tax Withheld.		
		$			$		

CONTINUE ON FORM 1042A.

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Form 1012

Monthly Return of Normal Income Tax to be Paid at Source

Form 1012 is the monthly return to be filed in duplicate on or before the 20th day of the month following that for which the return is made by the debtor corporation or its withholding agent with the collector of internal revenue for the district in which the debtor corporation or its withholding agent is located.

The return should include all items entered separately of interest on bonds, which contain or do not contain a "tax-free" covenant clause, of domestic and resident corporations, and foreign corporations having a paying agent in the United States with which items Form 1000 or Form 1059 have been filed.

If Form 1059 is substituted for Form 1000 by a bank or other paying agent, Forms 1000 so detached must be forwarded to the Commissioner of Internal Revenue.

A certificate on Form 1000 (or Form 1059 when substituted therefor) covering each payment entered thereon should accompany the return. In the absence of certificates covering registered bonds executed by the owner of the bonds (in cases in which Form 1000 should be filed), the debtor corporation or its withholding agent should prepare reports on Form 1000, which forms need not be signed.

Certificates on Form 1059 should be listed on the return, the serial number given the original certificate being entered in the column headed "Name of Payee."

If certificates of ownership do not accompany coupons, the first bank receiving such coupons should require of the payee an affidavit showing name and address of payee; name and address of debtor corporation; date of maturity of interest; name and address of person from whom the coupons were received; amount of interest; and a statement to the effect that the owner of the bonds is unknown to him. This affidavit shall be forwarded to the Commissioner of Internal Revenue with a return on Form 1012. The first bank should prepare Form 1000, crossing out "Owner" and inserting "Payee," entering the amount of interest, due date, and date paid, in the proper spaces and stamping or writing across the face of the certificate "Affidavit furnished (insert name of bank)."

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Collector will please leave the date of filing this return in the space provided by numbers.

THIS RETURN MUST BE MADE IN DUPLICATE TO THE COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT IN WHICH THE WITHHOLDING AGENT IS LOCATED, ON OR BEFORE MARCH 1, 1920, AND THE TAX MUST BE PAID OR DEPOSITED JUNE 15, 1920.

Form 1042—Revised January, 1920
UNITED STATES INTERNAL REVENUE SERVICE

ANNUAL RETURN OF NORMAL INCOME TAX TO BE PAID AT SOURCE

INTEREST ON BONDS AND OTHER SIMILAR OBLIGATIONS OF DOMESTIC AND RESIDENT CORPORATIONS AND FOREIGN CORPORATIONS HAVING A PAYING AGENT IN THE UNITED STATES

For the Calendar Year 1919

(Name of debtor organization)

(Address in full)

(Name of withholding agent)

(Address in full)

Do not write in this space
PAYMENT
$
(Cashier's Stamp)

CASH CHECK M.O.
Received by

INSTRUCTIONS

If debtor organization makes its own return, no entries need be made on lines provided for name and address of withholding agent.

This return must be made by debtor organizations, or their duly authorized withholding agents, and must show, by months in which the income was paid and reported on Form 1012, the total amount of tax to be paid at source on each of the following classes of payments:

1. Interest on bonds with tax-free-covenant clauses paid to citizens and residents of the United States (individuals and fiduciaries) not claiming personal exemption, to domestic and resident partnerships, to nonresident alien individuals or fiduciaries, to foreign partnerships, and to foreign corporations having no office or place of business in the United States. A normal tax of 2 per centum is required to be withheld and paid at source in each case.

2. Interest on bonds without tax-free-covenant clauses:
   (a) If paid to a nonresident alien individual, a normal tax of 2 per centum is required to be withheld and paid at source.
   (b) If paid to a foreign corporation having no office or place of business in the United States, a normal tax of 10 per centum is required to be withheld and paid at source.

MONTH	CLASS 1	CLASS 2 (a)	CLASS 2 (b)	TOTAL
JANUARY	$	$	$	$
FEBRUARY				
MARCH				
APRIL				
MAY				
JUNE				
JULY				
AUGUST				
SEPTEMBER				
OCTOBER				
NOVEMBER				
DECEMBER				
TOTALS	$	$	$	$
Less adjustments on account of Forms 1001B, attached hereto				
Amount of tax to be assessed				$

I swear (or affirm) that the above return is a full and complete summary of the amounts of normal tax (heretofore reported on monthly returns on Form 1012, which are hereby made a part of this return) required to be withheld from payments made by the above organization during the year 1919.

Sworn to and subscribed before me this _____

day of _____, *1920.*

_____
(Signature)

_____
(Title)

_____
(Signature)

_____
(Capacity in which acting)

_____
(Address in full)

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Form 1013

Annual Return of Normal Income Tax to be Paid at Source

Form 1013 is the annual return of normal tax withheld during the year, summarizing the monthly reports covered by Form 1012, and must be executed under oath and filed in duplicate on or before March 1, by the debtor corporation or its withholding agent, with the collector of internal revenue for the district in which the withholding corporation or its agent has its place of business. The tax withheld must be paid on or before June 15.

The payment of interest upon which no tax has been withheld should not be reported on Form 1013.

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Collector will stamp here the date of filing. If this return is not accompanied by remittance.

THIS RETURN MUST BE MADE IN DUPLICATE TO THE COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT IN WHICH THE WITHHOLDING AGENT IS LOCATED, ON OR BEFORE MARCH 1, 1919, AND THE TAX MUST BE PAID ON OR BEFORE JUNE 15, 1919.

Form 1042—Revised January, 1919
UNITED STATES INTERNAL REVENUE SERVICE

ANNUAL RETURN OF NORMAL INCOME TAX TO BE PAID AT SOURCE

SALARIES, WAGES, RENT, ETC., PAID TO NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS (NOT ENGAGED IN TRADE OR BUSINESS WITHIN THE UNITED STATES AND NOT HAVING ANY OFFICE OR PLACE OF BUSINESS THEREIN)

For the Calendar Year 1919

(Name of withholding agent)

(Address in full)

Do not write in this space

PAYMENT

$

(Cashier's Stamp)

CASH CHECK M.O.

Received by

1—1919

INSTRUCTIONS

This return is required to be made by all individuals, corporations, and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and officers and employees of the United States having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income of nonresident alien individuals or foreign corporations not engaged in trade or business within the United States, and not having any office or place of business within the United States.

The law requires that a tax equal to 2 per centum of the amount paid as salaries, wages, rent, etc., to individuals and 10 per centum of the amount paid to corporations shall be deducted and withheld. If any tax required to be deducted and withheld is paid by the recipient of the income, it shall not be recollected from the withholding agent. Income derived from dividends on the capital stock or from the net earnings of a corporation, joint-stock company, or insurance company, which is taxable upon its net income under the Revenue Act of 1918 is exempt from withholding and should not be reported.

This return must be accompanied by a report on Form 1096 of income paid for every item entered herein.

I swear (or affirm) that the following is a true and complete return of all payments of salaries, wages, interest, rents, etc., made during the calendar year 1919 by the above withholding agent and of the tax withheld on payments of income, as above described, to nonresident alien individuals and foreign corporations as defined above, the several items being evidenced by reports which are listed below and inclosed herewith showing the name and address of the recipient of the income, the kind and amount of income paid, and the amount of tax withheld.

I further declare that the amount of tax withheld is $.....

Sworn to and subscribed before me this ..... day of ....., 19.....

(Signature.)

(Signature.) (Title.) (Capacity in which acting.)

NAME OF INDIVIDUAL OR CORPORATION TO WHOM PAID	ADDRESS IN FULL	AMOUNT OF INCOME PAID	AMOUNT OF TAX WITHHELD
		$	$

Form 1042

Annual Return of Normal Income Tax to be Paid at Source

Form 1042 is the return of normal income tax withheld at source on payments of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual or periodical gains, profits and income paid during the year to nonresident alien individuals or foreign corporations not engaged in business and not having an office in the United States.

Interest on bonds of domestic and resident corporations should not be reported on this return. Dividends on the capital stock or from the net earnings of a corporation, joint stock company or insurance company, taxable upon its net income, is exempt from withholding and should not be reported.

Form 1042, executed under oath, must be filed in duplicate by the payor of the income with the collector of internal revenue for the district in which the payor is located, on or before March 1 of the year following that during which the payments were made. This return must be accompanied by a report on Form 1098 for each item entered thereon. The tax withheld must be paid on or before June 15.

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Form 1096.
(Revised January 1920)

UNITED STATES INTERNAL REVENUE SERVICE

ANNUAL INFORMATION RETURN

OF

PAYMENTS OF INCOME, ETC., REQUIRED TO BE REPORTED UNDER REVENUE ACT OF FEBRUARY 24, 1919

FOR CALENDAR YEAR 1919

FOR INSTRUCTIONS SEE REVERSE SIDE

THIS RETURN, ACCOMPANIED BY REPORTS ON FORM 1099, MUST BE FORWARDED SO AS TO REACH THE COMMISSIONER OF INTERNAL REVENUE, SORTING SECTION, WASHINGTON, D. C., ON OR BEFORE MARCH 15, 1920.

.....
(Name of person or organization by whom payments were made.)

.....
(Street and number or rural route.)

.....
(City.) (State.)

(Date received)

A	B	C
CHARACTER OF INCOME PAID.	NUMBER OF REPORT FORMS.	TOTAL AMOUNT OF PAYMENTS.
FORM 1099.—Interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable gains, profits, and income of $1,000 or more.....		$.....

(DO NOT WRITE IN THIS SPACE)

.....

.....

.....

.....

.....

IMPORTANT NOTICE.

Returns of information are required to be rendered on the basis of the calendar year. Returns for any other period of time will not be accepted.

If an adding machine tape was used in ascertaining the total reported in column C, it should be submitted with the return.

The name of the individual, corporation, partnership, etc., using Form 1099 may be printed or stamped on each form, if so desired, but this return must be made under oath.

Returns of individuals on this form must be signed and sworn to by the individual or his duly authorized agent. Returns of corporations, partnerships, etc., must be signed and sworn to by an officer of the corporation or member of firm.

I swear (or affirm) that to the best of my knowledge and belief the foregoing return and the accompanying reports constitute a true and complete statement of payments of the above-described classes of income made by the person or organization named at the head of this return during the calendar year 1919.

Sworn to and subscribed before me this ..... day

of....., 19....

.....
(Signature.)

.....
(Title.)

.....
(Signature.)

(State whether individual, member of firm, or duly authorized agent of Government bureau or office, or if officer of corporation give title.)

(Street address of person signing if different from that given as head of return.)

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Form 1096

Annual Information Return

Form 1096 is the annual return of information of payments of salaries, wages, rent, interest or other fixed or determinable gains. profits and income of $1,000 or more paid during the calendar year to any individual citizen or resident of the United States, domestic partnership, personal service corporation, or fiduciary, (See page 14).

This return is, in effect, a letter of transmittal of Forms 1099, showing the name and address of the payor of the income, the number of reports and the aggregate amount of payments thereon.

Organisations having one or more branch offices should file a complete return on this form showing all payments made by both the main and branch offices, accompanied by Forms 1099. It should be made from the main office and the locations of all branch offices should be noted thereon.

The return, which must be under oath, shall be filed with the Commissioner of Internal Revenue (Sorting Section), Washington, D. C., on or before March 15 for the preceding calendar year.

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Form 1000A—UNITED STATES INTERNAL REVENUE SERVICE

MONTHLY INFORMATION RETURN

PAYMENTS OF INTEREST ON BONDS OF DOMESTIC AND FOREIGN CORPORATIONS AND COUNTRIES AND DIVIDENDS ON STOCK OF FOREIGN CORPORATIONS

FOR MONTH OF _____, 19

THIS RETURN, ACCOMPANIED BY CERTIFICATES ON FORM 1001, 1001A, AND 1012, MUST BE MAILED TO THE COMMISSIONER OF INTERNAL REVENUE, SORTING DIVISION, WASHINGTON, D. C., ON OR BEFORE THE 20th DAY OF THE MONTH SUCCEEDING THAT FOR WHICH MADE

(Name of debtor organization)

(Full post-office address)

(Name of bank or paying agent)

(Full post-office address)

(Date received)

CLASS OF INCOME	NUMBER OF CERTIFICATES	TOTAL AMOUNT OF PAYMENTS
A. Interest on bonds and other similar obligations of domestic and resident corporations (provided tax was not withheld at source)	(FORM 1001)	$
B. Interest on bonds and other similar obligations of domestic and resident corporations (provided tax was not withheld at source)	(FORM 1001)	$
C. Interest on bonds of foreign corporations and countries and dividends on stock of foreign corporations	(FORM 1001A)	$

INSTRUCTIONS

A. A certificate on Form 1001 should accompany this return in every payment of interest on bonds and other similar obligations of domestic and resident corporations, under the following conditions:

1. *Interest on bonds with tax-free-covenant clauses* paid to citizens and residents of the United States (individuals and fiduciaries) claiming personal exemption, domestic and resident corporations, and foreign corporations having an office or place of business in the United States.

In the absence of ownership certificates made by individual owners of tax-free registered bonds the debtor organization shall prepare reports on Form 1000 and forward them to the collector with returns Form 1012. If owned by a domestic corporation, or foreign corporation having an office or place of business in the United States, reports on Form 1001 should be prepared. When so used the forms need not be signed.

2. *Interest on bonds without tax-free-covenant clauses* paid to citizens and residents of the United States (individuals and fiduciaries), domestic and resident partnerships and corporations, nonresident alien partnerships, and foreign corporations having an office or place of business in the United States.

In the case of registered bonds not having tax-free-covenant clauses the debtor organization will prepare reports on Form 1001 and forward them with this return to the Commissioner. When so used the form (1001) need not be signed.

B. Resident collecting agents, responsible banks and bankers receiving interest coupons presented by individual citizens or residents of the United States for collection, may detach certificate Form 1001 and forward it directly to the Commissioner of Internal Revenue, provided certificate Form 1058 (revised) is substituted for the certificate detached. The aggregate number of substitute certificates, Form 1058, should be entered by the debtor corporation on line B, in the column "Number of Certificates."

C. A certificate on Form 1001A should be required by individuals, partnerships, and corporations undertaking as a matter of business or for profit the collection of *interest on bonds of foreign corporations and countries and dividends on stock of foreign corporations* by means of coupons, checks, or bills of exchange for citizens and residents of the United States (individuals and fiduciaries), domestic and resident partnerships and corporations, and nonresident alien individuals, partnerships, and corporations.

If the payments consist of interest on bonds (and there is no paying agent in the United States), the last bank or collecting agent handling the item shall detach the certificate, Form 1001A, and forward it directly to the Commissioner of Internal Revenue, accompanied by a return on this form.

If the payments consist of dividends on stock of foreign corporations, the first bank or collecting agent receiving the certificate (Form 1001A) is required to detach and forward it directly to the Commissioner of Internal Revenue. The first bank shall indorse upon the foreign item "Certificate detached and information furnished (insert name and address of licensee)." Substitute certificates are not permitted to be used in the case of foreign items.

If bonds are owned jointly, separate certificates should be made by or for each joint owner. Fiduciaries must enter on the certificates under "Owner of bonds" the name of estate, trust, or beneficiary on behalf of whom the exemption is claimed. Licensed banks and collecting agents not acting as withholding or paying agents for debtor organizations may file one return on this form, making no entries in the spaces at the head of the form for name and address of debtor organization.

I CERTIFY that the foregoing return and the accompanying certificates constitute a true and complete statement of payments of the above-described classes of income made by the person or organization named at the head of this return, during the month stated above.

Dated _____

_____
(Signature)

_____
(Signature if made otherwise)

_____
(Address in full)

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Form 1096-A

Monthly Information Return

Form 1096-A is the monthly return of information of payments of interest on bonds of domestic and foreign corporations and foreign countries, and dividends on stock of foreign corporations, with which items ownership certificates Form 1001 and Form 1001-A have been filed, disclosing that no withholding is required.

This return should be filed by the debtor corporation or its paying agent with the Commissioner of Internal Revenue (Sorting Division), Washington, D. C., on or before the 20th day of the month succeeding that for which made, accompanied by certificates on Form 1001 (or on Form 1058 when substituted therefor) and on Form 1001-A.

In the absence of ownership certificates made by individual owners of "tax-free" covenant registered bonds, the debtor corporation shall prepare reports on Form 1000 and forward them to the Collector with return Form 1012. If owned by a domestic corporation, or foreign corporation having an office or place of business in the United States, reports on Form 1001 should be prepared. In the case of registered bonds not having "tax-free" covenant clauses, the debtor corporation shall prepare reports on Form 1001 and forward them to the Commissioner with return Form 1096-A. Forms 1000 and 1001 when so used need not be signed.

In the case of interest on bonds of foreign corporations and foreign countries, the return should be made by the paying agent in this country. If there is no paying agent in this country, then by the last bank or collecting agent. In the case of dividends on stock of foreign corporations, the first bank or collecting agent receiving the certificate (Form 1001-A) is required to detach and forward it directly to the Commissioner of Internal Revenue, endorsing upon the foreign item "Certificate detached and information furnished (inserting name and address of licensee)."

Substitute certificates are not permitted to be used in the case of foreign items.

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Form 1099 D (Revised January, 1919) UNITED STATES INTERNAL REVENUE SERVICE

ANNUAL INFORMATION RETURN

PAYMENTS OF INTEREST ON BONDS OF DOMESTIC AND FOREIGN CORPORATIONS AND COUNTIES AND DIVIDENDS ON STOCK OF FOREIGN CORPORATIONS

For Calendar Year 19....

THIS RETURN MUST BE FORWARDED SO AS TO REACH THE COMMISSIONER OF INTERNAL REVENUE SORTING DIVISION WASHINGTON, D. C. ON OR BEFORE MARCH 15, OF THE FOLLOWING YEAR.

(Name of debtor corporation.)

(Full post-office address.)

(Name of bank or paying agent.)

(Full post-office address.)

(State reporting)*

MONTH	A. Interest on bonds and other similar obligations of domestic and resident corporations				B. Interest on bonds of foreign corporations and counties and dividends on stock of foreign corporations			
	Number of certificates	Amount			Number of certificates	Amount		
January		$				$		
February								
March								
April								
May								
June								
July								
August								
September								
October								
November								
December								
Total		$				$		

This return must be made by debtor corporations, paying agents, or banks, and must show, by months in which the income was paid and reported on monthly returns, the total number of exemption certificates filed with such returns and the total income paid without deduction of tax, as shown by such certificates and returns.

I swear (or affirm) that this return is a full and complete summary of the number of exemption certificates and amount of income of the classes shown above (heretofore reported on monthly returns, which are hereby made a part of this return), paid during the year.

Sworn to and subscribed before me this ..... day of ....., 19....

(Signature.)*

(Capacity in which acting.)

(Signature.)

(Title.)

(Address in full.)

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Form 1096-B

Annual Information Return

Form 1096-B is the annual return of payments of interest on bonds and other similar obligations of domestic and foreign corporations and foreign countries, and dividends on stocks of foreign corporations.

This return must be filed with the Commissioner of Internal Revenue (Sorting Division), Washington, D. C., by the debtor corporation, paying agent, or bank which is the source of information, on or before March 15 of the year following that for which the return is made, and must show, by months in which the income was paid and reported on monthly returns (Form 1096-A, page 51), the total number of exemption certificates filed with such returns, and the total income paid without deduction of tax as shown by such certificates and returns. The return must be executed under oath.

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The Withholding Agent or Collector Receiving This Claim Shall Enter Date of Receipt in This Space.		Do Not Write Here
	TREASURY DEPARTMENT Form 1040—United States Internal Revenue Service **CLAIM BY NONRESIDENT ALIEN INDIVIDUAL** For Benefit of Personal Exemption and Credit for Dependents FOR TAXABLE YEAR _____	

_____ (Name of claimant (agent)) _____ (Street and number)

_____ (City or town) _____ (State)

Claim is hereby made for benefit of the personal exemption and the credit for dependents (if any) provided under section 216 of the Revenue Act of 1918 by (or for)—

Name of claimant _____

Address in the United States _____

1. Of what country are you a citizen or subject? _____
2. Are you single? _____ 3. Are you married and living with wife or husband? _____
4. Are you head of a family? _____ 5. If head of a family, give age and relationship of those dependent upon you _____
6. If married, has your wife or husband derived income during the taxable year to date from sources in the United States separate from your own? _____
7. If so, is such income included in the income stated below? _____
8. Have you filed a return of net income for all or any of the past four years? _____ 9. If so, state for which years and the Internal Revenue Districts in which filed _____

INCOME OF CLAIMANT, DURING TAXABLE YEAR TO DATE, FROM SOURCES WITHIN THE UNITED STATES.

(I) Salary or Wages.

Name of Employer.	Address.	Period.	Amount.	
			$	
				$

(II) Other Income.

Class or Source.	Address.	Period or Date.	Amount.	
			$	
				$

Total income of claimant, during taxable year to date, from sources within the United States (X) $ _____

STATEMENT OF CREDITS CLAIMED.

Amount of credits claimed: Personal exemption, $ _____ Credit for dependents, $ _____ Total (Y) $ _____

Total income of claimant, during taxable year to date, from sources within the United States (Item X from above) _____

Balance of credit (Item Y minus Item X) _____ $ _____

I swear (or affirm) that the above is, to the best of my knowledge and belief, a true and complete statement of facts in connection with the claim for credits above made.

_____ (If claim is made by agent the exact character must be stated on this line.)

Sworn to (or affirmed) and subscribed before me this _____ day of _____ 19____

_____ (Signature of individual or agent.)

_____ (Official capacity.) [SEAL.] _____ (Address of individual or agent.)

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Form 1115

Claim by Nonresident Alien Employee for Exemption from Withholding

Form 1115 may be filed by nonresident alien employees with their employers to claim credit for personal exemption, and credit for dependents, or both, in the collection of salary, wages, or other fixed or determinable annual or periodical compensation. A nonresident alien individual is permitted to claim such credit only if the country of which he is a citizen or subject allows a similar credit for personal exemption or credit for dependents, as the case may be, and allows it without discrimination to citizens of the United States not residing in such country. To satisfy the requirements of a "similar credit" it is not necessary that the personal exemption or credit for dependents should be the same as that allowed by the United States statute. For list of foreign countries, citizens or subjects of which are entitled to exemptions, see pages 7 and 8.

Every employer who receives Form 1115, duly filled out and executed under oath, should examine it, and if it appears that the claim is in due form, that it contains no statement which to the knowledge of the employer is untrue, that such employee on the face of the claim is entitled to credit, and that such credit has not been exhausted, the employer need not, until such credit is in fact exhausted, withhold any tax from payments of salary or wages made to such employee.

All affidavits on Form 1115 should be preserved by the employer until the following calendar year and should then be filed with his annual withholding return on Form 1042 with the collector on or before March 1. In case, however, the employer has no withholding to return, all such affidavits of claim so filed with him by employees should be filed directly with the Commissioner of Internal Revenue (Sorting Division), Washington, D.C. with a letter of transmittal on or before March 15.

In all other cases benefit of the credits allowed against net income for the purpose of the normal tax may not be received by a nonresident alien by filing a claim with the withholding agent, but only by claiming them upon filing a return of income in prescribed form.

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Transportation Act 1920

Guaranty Trust Company
of New York

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Transportation Act 1920

Approved February 28, 1920

Guaranty Trust Company of New York

140 Broadway

FIFTH AVENUE OFFICE
Fifth Avenue and 43rd Street

MADISON AVENUE OFFICE
Madison Avenue and 60th Street

GRAND STREET OFFICE
268 Grand Street

LONDON LIVERPOOL PARIS HAVRE BRUSSELS

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GUARANTY TRUST COMPANY OF NEW YORK

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Foreword

THE Transportation Act, 1920, approved February 28, 1920, by which the Government returns the railroads to their owners, is one of the most important reconstruction measures that Congress has enacted. Many plans for the return of the roads to private control were submitted. The new legislation embodies the plan and the conditions upon which Congress has decided the President shall relinquish control, and the owners resume operation, on March 1, 1920.

The text of the law has been printed from the report of the Conference Committee and, although we cannot guarantee its accuracy, we believe it to be correct.

This booklet contains a general summary and the text of the Transportation Act, 1920, fully indexed, together with a brief review of prior laws pertaining to Federal regulation.

GUARANTY TRUST COMPANY OF NEW YORK.

March 1, 1920.

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Prior Laws Pertaining to Federal Regulation

The Federal regulation of railroads in the United States virtually began with the enactment in 1887 of the Interstate Commerce Act, creating an Interstate Commerce Commission of five members to be appointed by the President with the advice and by the consent of the Senate. The Act applied to interstate and foreign freight and passenger traffic carried by railroads, or in the case of continuous shipment, by rail and water, but it did not apply to intrastate traffic, nor to interstate or foreign traffic carried entirely by water.

The Interstate Commerce Commission was vested with important powers with respect to the transportation systems of the nation. Among other things, the Act prohibited pooling, and all unjust personal discriminations in the form of special rates, rebates or otherwise, forbade discriminations between localities, commodities and connecting lines, and required the provision of reasonable and equal facilities for the interchange of traffic. The Act also provided that all charges should be just and reasonable, and required rates and fares to be printed and posted for public inspection.

Although the provisions of the law appeared to be sufficiently comprehensive, it never accomplished the results anticipated by its framers, partly because, under the law, the orders of the Interstate Commerce Commission were not binding upon the railroads unless a

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Circuit Court of the United States compelled obedience, but chiefly because the courts so interpreted its main provisions as greatly to limit its scope. It was intended that the functions of the courts in connection with investigations by the Commission were to be confined to reviewing questions of law which might be involved in the enforcement of the Commission's orders. The courts, however, went much further than this and permitted the introduction of evidence which had not been submitted to the Commission. This practice naturally reduced the effectiveness of the Commission as an investigating body, inasmuch as it led to much duplication of effort, caused long delays in adjudication, and greatly increased the expense of litigation, thereby discouraging the submission of grievances to the Commission.

In spite of the failure of the law to accomplish the ends most desired, many beneficial results came from the legislation, among which may be mentioned publicity of rates, reduction of the number of freight classifications, and a better adjustment of charges, as between different shippers, different localities, and different commodities.

The next important step in the development of Government regulation of interstate commerce was the enactment of the Elkins Act of February 19, 1903, which made corporations as well as their agents liable for violation of laws relating to interstate commerce, and made deviation from the published schedules of rates the sole test of discrimination. The Expediting Act of 1903 gave all cases pending in any Circuit Court of the United States and brought under the Interstate Commerce Act, the Sherman Anti-trust Act of 1890, or any other acts having a like purpose, in

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which the United States Government was the complainant, precedence over all other cases.

In 1906 the Hepburn Amendment was enacted, which greatly increased the powers of the Interstate Commerce Commission, and extended the scope of the original act, making it applicable to express companies, sleeping-car companies and pipe lines for transporting oil or other commodities except water and gas, and increasing considerably the things included in the terms "railroad" and "transportation." The law specifically invested the Commission with rate-making powers which had been denied to it under the interpretations which the courts had placed on the provisions of the Act of 1887. The prestige of the Commission was also greatly increased by a provision to the effect that all its orders except those for the payment of money should take effect within such reasonable time, not less than 30 days, as the Commission should prescribe. This law also conferred upon the Commission the power to prescribe a uniform system of accounts for railroads engaged in interstate commerce, and contained provisions further discouraging rebating.

The enactment of the Carmack Amendment of 1906 was of great advantage to shippers, since it required the carrier receiving traffic for interstate shipment to issue a bill of lading for such shipment, and made it liable to the lawful holder of the bill for any loss or damage caused by any carrier over whose lines it might pass. The initial carrier was allowed to recover from the carrier on whose lines the damage occured.

In 1910 the powers of the Commission were still further increased by the Mann-Elkins Amendment. Among other things, this Act vested the Commission

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with authority to suspend new rate schedules proposed by carriers until opportunity had been afforded the Commission to determine by investigation whether the proposed increases were justified.

The Panama Canal Act of August 24, 1912, prohibited any railroad company or other common carrier subject to the Act from owning, leasing, operating, controlling, or having any interest in common carriers by water or any vessel carrying freight or passengers operating through the Panama Canal or elsewhere in competition with such railroad or other carrier. This Act also vested in the Commission the authority to require the connection of rail and water carriers where reasonably practicable; to establish through routes and maximum joint rates over rail and water lines; to establish maximum proportional railroad rates to and from ports; and to order any railway, entering into any arrangements with a carrier by water operating from any port in the United States for handling through business between an interior point therein and a foreign country, to enter into similar arrangements with any or all steamship lines operating from that port to the same foreign country.

There were two important measures affecting the railroads enacted on July 2, 1890, and on October 15, 1914, respectively. The former was the Sherman Anti-Trust Law which made contracts, combinations in the form of a trust or otherwise, or conspiracies in restraint of interstate or foreign trade or commerce illegal. Many illegal combinations were dissolved after the enactment of this law. The Clayton Act forbade all corporations engaged in interstate commerce to acquire stock of another such corporation where the competition might thereby be lessened, commerce restrained

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in any section, or a monopoly thereby created of any line of commerce. It was expressly provided that the law should not apply to corporations purchasing such stock for investment purposes solely, nor be construed as prohibiting a carrier, through the acquisition of stock, from aiding in the construction of short branch lines, nor prevent the extension of its lines through acquisition of such stock where no substantial competition existed between the purchasing and selling corporations. The Interstate Commerce Commission was vested with authority to compel compliance with those sections of the Clayton Act applicable to common carriers.

Under the Act approved August 29, 1916, the President was empowered to take possession and assume control of any system or systems of transportation and to utilize them to the exclusion, as far as necessary, of all other traffic for the transportation of troops, war material, and equipment, and for needful and desirable purposes connected with the prosecution of the war. Acting under the authority vested in him by this Act, the President on December 26, 1917, issued a proclamation assuming control of all systems of transportation located wholly or in part within the boundaries of the continental United States, such control becoming effective on December 28, 1917.

On March 21, 1918, the Federal Control Act was signed by the President. This Act provided for the operation of the properties of the carriers during the war and for a reasonable time thereafter, not exceeding 21 months from the date of the President's proclamation of the exchange of ratification of the treaty of peace, and for compensation for the use of their properties while under Federal Control.

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This legislation was designed only to meet the emergency conditions arising from the war and it was specifically provided therein that it was not to be construed as expressing the future policy of the Government concerning the ownership, control or regulation of the carriers or the method or basis of their capitalization. With the war ended, it became incumbent upon Congress to enact the necessary legislation to bring about the return of the railroads to their original owners and many plans were brought forward, designed to accomplish this result. Among these may be mentioned the plans offered by the railway executives; by the security owners; by the rail way brotherhoods, which, under the name of the Plumb Plan, advocated purchase of the railroads by the Government and operation by the employees; by the National Transportation Conference, representing a composite of the ideas of the various interests involved; by the Senate Interstate Commerce Committee, known as the Cummins Bill; and by the Interstate Commerce Commission, known as the Esch Bill.

On December 24, 1919, the President issued a proclamation relinquishing control and operation of the railroads, such relinquishment to be effective at 12.01 a.m. March 1, 1920. The approach of the termination of the period of Federal control emphasized the necessity for immediate action by Congress. As a result, the Senate passed the Cummins Bill and the House passed the Esch Bill, each with numerous changes and amendments. The Conferees of the Senate and House, after considering the two bills, made their report which was approved by both Houses and became a law on February 28, 1920 upon being signed by the President.

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Summary of the Transportation Act, 1920

Termination of Federal Control

Under the provisions of the Act, Federal control* will terminate at 12:01 a. m., March 1, 1920, at which time the President will relinquish possession and control of all railroads and systems of transportation then under Federal control and will discontinue Federal operation. Thereafter the President shall not have or exercise any of the powers conferred upon him by the Federal Control Act relating to—

(1) The use or operation of railroads or systems of transportation;
(2) The control or supervision of the carriers owning or operating them, or of their business or affairs;
(3) Their rates, fares, charges, classifications, regulations, or practices;
(4) The purchase, construction, or other acquisition of transportation facilities on the inland, canal, or coastwise waterways, or (except in pursuance of contracts entered into before the termination of Federal control) of terminals, motive power, cars, or equipment, on or in connection with any railroad or system of transportation;
(5) The utilization or operation of canals;
(6) The purchase of securities of carriers, except in pursuance of contracts entered into before the termination of Federal control, or as a necessary or proper

* "Federal control" means the possession, use, control, and operation of railroads and systems of transportation taken over or assumed by the President under Section 1 of the Act of August 29, 1916, or under the Federal Control Act.

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incident to the adjustment, settlement, liquidation and winding up of matters arising out of Federal control; or

(7) The use of the revolving fund created by the Act of March 21, 1918, or any of the additions thereto, made under such Act or by the Act of June 30, 1919, for any of the purposes above stated, except in pursuance of contracts entered into before the termination of Federal control and for the settlement of matters arising out of it and except as provided in Section 202 (page 40).

The power conferred upon the President, under the Act of August 29, 1916, with respect to taking possession, assuming control and utilizing any system of transportation in time of war is not affected by this Act.

All transportation facilities on the inland, canal and coastwise waterways acquired by the United States under Section 6 of the Federal Control Act, except those constituting parts of railroads or transportation systems over which Federal control was assumed, are transferred to the Secretary of War, who shall operate or cause the same to be operated in accordance with the provisions of Section 201 (page 39).

Settlement of Matters Arising Out of Federal Control

As soon as practicable after the termination of Federal control the President is directed to wind up all matters arising out of and incident to Federal control. In addition to other funds which are made available for the purpose, the sum of $200,000,000 is appropriated.

The President is also given the right, at all reasonable times until the affairs of Federal control are concluded, to inspect the property and records of all

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systems of transportation which were under Federal control at any time, if such action is necessary (1) to protect the interests of the United States; (2) to supervise matters being handled for the United States by agents of the carriers; or, (3) to secure information concerning matters arising during Federal control. Carriers are required to provide all reasonable facilities therefor and, upon request of the President, to furnish all necessary and proper information and reports compiled from the records kept during the period of Federal control. They must also keep and continue such records and furnish like information and reports compiled therefrom.

Compensation of Carriers With Which No Contract Was Made

Upon request of any carrier entitled to just compensation under the Federal Control Act, but with which no contract, fixing or waiving compensation, has been made and which has made no waiver of compensation, the President

(1) shall pay it so much of the amount he may determine to be just compensation, as may be necessary to meet corporate charges and expenses referred to in paragraph (b) of Section 7 of the standard contract between the United States and the carriers, accruing during the period for which such carrier is entitled to just compensation under the Federal Control Act, and also the sums required for dividends; and

(2) may, in his discretion, pay it the whole or any part of the remainder of such estimated amount of just compensation.

The acceptance, however, of any of the above benefits by a carrier shall not deprive it of the right to claim additional compensation, which unless agreed upon

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shall be ascertained as provided in Section 3 of the Federal Control Act, but shall constitute an acceptance of all its provisions as modified by this Act, and shall obligate the carrier to pay to the United States, with interest at the rate of six per centum per annum from a date or dates fixed in proceedings under Section 3 of the Federal Control Act, the amount by which the sums received on account of such compensation under this section or otherwise exceed the sum found due in such proceedings (Section 203).

Reimbursement of Deficits During Federal Control

As soon as practicable after March 1, 1920, the Interstate Commerce Commission shall ascertain for every carrier, as defined in Section 204, for every month of the period of Federal control during which its system of transportation was not under Federal operation, its deficit in railway operating income, if any, and its railway operating income, if any, (called "Federal control return") and the average of each, if any, for the three corresponding months of the test period* taken together (called "test period return"†).

For every month of the period of Federal control during which a carrier's system was not under Federal operation, the Commission shall ascertain:

(1) the difference between its Federal control return, if a deficit, and its test period return, if a smaller deficit, or

* "Test period" means the three years ending June 30, 1917.

† "Test period return" in the case of a carrier which operated its railroad or system of transportation for at least one year during, but not for the whole of, the test period, means its railway operating income, or the deficit therein for the corresponding month during the test period, or the average thereof for the corresponding months during the test period taken together, during which the carrier operated its railroad or system of transportation.

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(2) the difference between its test period return, if an income, and its Federal control return, if a smaller income, or

(3) the sum of its Federal control return, if a deficit, plus its test period return, if an income.

The sum of such amounts shall be credited to the carrier.

For every such month the Commission shall ascertain:

(1) the difference between the carrier's Federal control return, if an income, and its test period return, if a smaller income, or

(2) the difference between its test period return, if a deficit, and its Federal control return, if a smaller deficit, or

(3) the sum of its Federal control return, if an income, plus its test period return, if a deficit.

The sum of such amounts shall be credited to the United States.

If the sum of the amounts credited to the carrier exceeds the sum of the amounts credited to the United States, the difference shall be payable to the carrier. In the case of a carrier which operated its system for less than a year during, or for none of, the test period, the above computation shall not be used, but the carrier shall receive its deficit in operating income for that portion (as a whole) of the period of Federal control during which it operated its own system.

Legal Proceedings Arising Out of Federal Control

Legal proceedings, based on causes arising out of Federal control, which prior to Federal control could have been brought against the carrier, shall be brought against an agent designated by the President. Such

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proceedings may be instituted within periods of limitations prescribed by law but not later than two years after the passage of this Act, in any court which but for Federal control would have had jurisdiction of the cause of action had it arisen against the carrier. The procedure to be followed in serving process in connection with such proceedings is outlined in Section 206.

Claims for reparation on account of damage caused by the collection or enforcement by or through the President during the period of Federal control of rates, classifications, regulations or practices (including those applicable to interstate, foreign, or intrastate traffic), which were unjust, unreasonable, unjustly discriminatory or unduly or unreasonably prejudicial, or otherwise in violation of the Interstate Commerce Act, may be filed with the Commission within one year after the termination of Federal control against the agent designated by the President. The Commission is given jurisdiction to hear and decide such complaints, as provided in the Interstate Commerce Act. All such actions and reparation claims pending at the termination of Federal control shall not abate by reason of such termination, but may be prosecuted to final judgment, substituting the agent designated by the President. Final judgments and awards shall be paid out of the revolving fund created by Section 210 (page 57).

The period of Federal control shall not be computed as part of the periods of limitation in actions against carriers or in claims for reparation to the Commission for causes of action arising prior to Federal control. No execution or process other than on a judgment recovered by the United States against a carrier shall be

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levied upon the property of any carrier where the cause of action grew out of the possession, use, control or operation of any system of transportation by the President under Federal control.

Refunding of Carriers' Indebtedness to United States

As soon as practicable after the termination of Federal control the President shall ascertain

(1) the amount of each carrier's indebtedness to the United States at the termination of Federal control incurred for additions and betterments made during Federal control and properly chargeable to capital account, or otherwise incurred;

(2) the amount of indebtedness of the United States to the carrier arising out of Federal control, which amount may be set off against class (1) so far as the President may deem wise; but only to the extent permitted under any contract now or hereafter made between the carrier and the United States in respect to the matters of Federal control; or where no such contract exists, to the extent permitted under paragraph (b) of Section 7 of the standard contract relative to deductions from compensation.

The right of set-off shall not be exercised so as to prevent the carrier from having (1) the sums required for corporate charges and expenses referred to in paragraph (b) of Section 7 of the standard contract, accruing during Federal control, and (2) the sums required for dividends declared and paid during Federal control, including also a sum equal to that proportion of such last dividend which the period between its payment and the termination of Federal control bears to the last regular dividend period. Nor shall such right of set-off be exercised unless there shall have first been paid such additional sums as may be necessary to pro-

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vide the carrier with working capital in an amount not less than one twenty-fourth of its operating expenses for the calendar year 1919.

At the request of the carrier, any remaining indebtedness to the United States in respect to such additions and betterments shall be funded for a period of ten years from the termination of Federal control or for a shorter period at the option of the carrier, with interest at the rate of six per centum per annum, payable semi-annually, subject to the right of the carrier to pay on any interest-payment day, the whole or any part of such indebtedness. A carrier obtaining the funding of such indebtedness shall give such security as the President may prescribe.

If the President and any of the various carriers shall enter into an agreement for funding through the medium of car trust certificates or otherwise, the indebtedness to the United States incurred for equipment ordered for the benefit of the carrier, such indebtedness so funded shall not be refundable under the above provisions. Any other indebtedness to the United States, which may exist after the settlement of accounts and which is then due, shall be evidenced by notes payable in one year from the termination of Federal control, or a shorter period, at the option of the carrier, with interest at the rate of six per centum per annum, and secured by such collateral security as the President may require.

The President shall have the right to make such arrangements for extension of the time of payment of any bonds, notes or other securities, acquired under the provisions of this Act, (Section 207) or of the Federal Control Act, or of the Act of November 19, 1919, or for their exchange for other securities, or

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partly for cash and partly for securities, as may be provided for in any agreement entered into by him or as may in his judgment seem desirable.

By agreement with the President, carriers may issue notes or other evidences of indebtedness secured by equipment trust agreements, for equipment purchased during Federal control by or through the President under Section 6 of the Federal Control Act, and allocated to such carriers respectively. The carrier may issue such evidences of indebtedness pursuant to this section without the authorization or approval of any state or Federal authority, and without compliance with any state or Federal requirement as to notification.

Rates

All rates, and all classifications, regulations and practices, changing, affecting or determining any part of, or the aggregate of, rates, or the value of the service rendered, which on February 29, 1920, are in effect on the lines of carriers subject to the Interstate Commerce Act, shall continue in force until thereafter changed by Federal or state authority, or pursuant to authority of law. Prior to September 1, 1920, no such rate shall be reduced and no such classification, regulation or practice shall be changed so as to reduce any rate unless such reduction or change is approved by the Commission.

All divisions of joint rates in effect on February 29, 1920, between the lines of carriers subject to the Interstate Commerce Act, shall continue in force until thereafter changed by mutual agreement between the interested carriers or by state or Federal authorities.

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Guaranty to Carriers After Termination of Federal Control.

Under Section 209 of the Act, the United States guarantees to carriers, as therein defined, operating income as follows:

(1) With respect to any carrier with which a contract (except a cooperative contract or waiver) fixing compensation has been made, that the railway operating income for the guaranty period, namely, the six months beginning March 1, 1920, as a whole, shall not be less than the amount named as annual compensation, or where the contract fixed a lump sum for the whole period of Federal operation, that the railway operating income for the guaranty period as a whole shall not be less than an amount which shall bear the same proportion to the lump sum so fixed as six months bears to the number of months during which the carrier was under Federal operation, including in both cases the increases in such compensation provided for in Section 4 of the Federal Control Act;

(2) With respect to any carrier entitled to just compensation under the Federal Control Act, with which such contract has not been made, that the railway operating income for the guaranty period as a whole shall not be less than one-half of the annual amount estimated by the President under the Federal Control Act, including the increases in such compensation provided for in Section 4 of that Act. If a carrier does not accept the President's estimate and tries its remedy in the Court of Claims, in which proceeding it is determined that a larger or smaller annual amount is due, the guaranty shall be increased or decreased accordingly;

(3) With respect to any carrier, whether or not entitled to just compensation under the Federal Control Act, with which such a contract has not been made, and as to which no estimate of just compensation is

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made by the President, and which in the test period sustained a deficit in railway operating income, the guaranty shall be the amount by which the deficit for the guaranty period as a whole exceeds one-half of its average annual deficit, plus an amount equal to one-half the annual sum fixed by the President under Section 4 of the Federal Control Act;

(4) With respect to any carrier not entitled to just compensation under the Federal Control Act, which for the test period as a whole had an average annual railway operating income, that the guaranty shall be not less than one-half of the average annual railway operating income of such carrier during the test period.

If for the guaranty period as a whole the railway operating income of any carrier entitled to a guaranty under (1), (2) or (4) above exceeds the minimum railway operating income guaranteed therein, or under (3) above exceeds one-half of the annual sum fixed by the President with respect to such carrier under Section 4 of the Federal Control Act, such carrier shall pay the amount of such excess into the Treasury of the United States. Any carrier, however, may retain out of any such excess an amount necessary to enable it to pay its fixed charges accruing during the guaranty period. The definition of "railway operating income" and the details of its determination are contained in Section 209 (page 50).

The Commission shall, as soon as practicable after the expiration of the guaranty period, ascertain and certify to the Secretary of the Treasury the amount necessary to make good the guaranty to each carrier.

Upon application to the Commission, advances may be made to the carrier, during the guaranty period, not in excess of the estimated amount of the guaranty, to enable it to meet its fixed charges and operating expenses.

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American Railway Express Company

The contract of June 26, 1918, between the American Railway Express Company and the Director General of Railroads, as amended and continued by the agreement of November 21, 1918, in so far as it constitutes a guaranty on the part of the United States against a deficit in operating income, is to remain in full force and effect during the guaranty period, if the Company files with the Interstate Commerce Commission not later than March 15, 1920, a statement that it accepts all the provisions of subdivision (i) of Section 209 of the law.

For the guaranty period, the American Railway Express Company shall pay to every carrier accepting the provisions of Section 209 regarding the guaranty, 50.25% of the gross revenue earned from all its express traffic on the carrier's lines, and the carrier shall accept from the former such percentage of the gross revenue as its compensation.

In arriving at the gross revenue on through or joint express traffic, the method of dividing the revenue between the carriers shall be that agreed upon between the carriers and the express company with the approval of the Commission.

If for the guaranty period the American Railway Express Company has no deficit in operating income, it shall pay the amount of its operating income for such period into the Treasury of the United States.

Upon application of the American Railway Express Company requesting during the guaranty period an advance of such sums, not exceeding the estimated amount necessary to make good the guaranty, as are necessary to enable it to meet its operating expenses,

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the Commission may certify to the Secretary of the Treasury the amount of and times at which such advances shall be made. The Secretary is thereupon empowered to make such advances upon the execution by the Company of a contract with proper security, that upon final determination of the amount of the guaranty, the company will repay to the United States any amounts received from such advances in excess of the guaranty with interest at the rate of 6 per centum per annum from the time such excess was paid.

New Loans to Railways

During the period of transition immediately following the termination of Federal control, any carrier may at any time after the passage of this Act and before the expiration of two years after the termination of Federal control apply to the Commission for a loan from the United States, stating (1) the amount of and purpose of the loan and the uses to which it will be applied, (2) the term for which desired, (3) the present and prospective ability of the applicant to repay the loan and meet the requirements of its obligations in that regard, (4) the character and value of the security offered, and (5) the extent to which the public convenience and necessity will be served. The application must be accompanied by the other data called for in Section 210.

If it is found that the making of the proposed loan or any part thereof by the United States is necessary to enable the applicant to properly meet the transportation needs of the public and that the prospective earning power and the character and value of the security offered are sufficient to furnish reasonable assurance of the ability to repay the loan within the

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time fixed and to meet its other obligations in connection with the loan, the Commission may certify its findings of fact and its recommendations to the Secretary of the Treasury as to the amount of the loan which is to be made, the time, not exceeding five years from the making thereof, within which it is to be repaid, the character of the security offered, and the terms and conditions of the loan. The Secretary of the Treasury is authorized at any time before the expiration of 26 months after the termination of Federal control to make a loan not exceeding the maximum amount recommended in the certificate, out of any moneys in the revolving fund of $300,000,000 provided for by Section 210. Such loans shall bear interest at the rate of 6 per centum per annum and be placed to the credit of the revolving fund. The Secretary of the Treasury shall prescribe the time, not exceeding five years from the making thereof, within which such loan is to be repaid, the security which is to be taken therefor, the terms and conditions of the loan, and the form of the obligation to be entered into.

A carrier may issue evidences of indebtedness to the United States pursuant to the provisions of Section 210, without the authorization or approval of any state or Federal authority and without compliance with any state or Federal requirement as to notification.

Disputes Between Carriers and Their Employees and Subordinate Officials

The law provides that it shall be the duty of all carriers, as defined in Section 300 (page 58), and their officers, employees and agents to exert every reasonable effort and adopt every available means to

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avoid any interruption to the operation of any carrier growing out of any dispute between the carrier and the employees or subordinate officials thereof. All such disputes are to be considered and, if possible, decided in conference between representatives designated and authorized so to confer by the carriers or the employees or subordinate officials thereof directly interested in the dispute.

As a means of effecting settlement of such disputes, the law further provides that Railroad Boards of Labor Adjustment may be established by agreement between carriers and their employees or subordinate officials or organizations thereof. Each such Adjustment Board is to receive for hearing and decide disputes involving only grievances, rules, or working conditions, not decided in conference, as provided above, between the carrier and its employees or subordinate officials, who are, or any organization thereof which is, represented upon any such Adjustment Board.

Disputes may be brought before the Adjustment Board upon

(1) The application of the chief executive of any carrier or organization of employees or subordinate officials whose members are directly interested in the dispute,

(2) A written petition signed by at least one hundred unorganized employees or subordinate officials directly interested in the dispute,

(3) The Adjustment Board's own motion, or

(4) The request of the Labor Board, whenever such Board is of the opinion that the dispute is likely to substantially interrupt commerce.

As a further means of settling disputes, a board is created to be known as the Railroad Labor Board, to be composed of nine members selected as follows:

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(1) Three members representing employees and subordinate officials, to be appointed by the President with the consent of the Senate, from not less than six nominees offered by such employees;

(2) Three members representing the carriers, to be appointed by the President with the consent of the Senate, from not less than six nominees offered by the carriers; and

(3) Three members representing the public, to be appointed directly by the President with the consent of the Senate.

Any member of the Labor Board who, during his term of office, is an active member or in the employ of or holds any office in any organization of employees or subordinate officials or any carrier, or who owns any stocks or bonds thereof, or who is pecuniarily interested therein, is ineligible for membership upon the Board. No member, however, is required to relinquish honorary membership in, or his rights in any insurance or pension or other benefit fund maintained by any organization of employees or subordinate officials or by a carrier.

The Labor Board is empowered to hear and decide disputes involving grievances, rules, or working conditions, upon certification to it by any Adjustment Board that in its opinion it has failed or will fail to reach a decision within a reasonable time, or in respect of which the Labor Board determines that any Adjustment Board has so failed or is not using due diligence in its consideration thereof.

Where an appropriate Adjustment Board is not organized the Labor Board shall receive for hearing and decide disputes involving grievances, rules, or working conditions which are not decided by conference between the carriers, their employees, or

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subordinate officials, and which such Adjustment Board would be required to receive for hearing and decision. It shall also receive for hearing and decide disputes with respect to wages or salaries not decided by conference between carriers, their employees or subordinate officials.

The Labor Board shall for these purposes act upon

(1) The application of the chief executive of any carrier or organization of employees or subordinate officials whose members are directly interested in the dispute,

(2) A written petition signed by not less than one hundred unorganized employees or subordinate officials directly interested in the dispute, or

(3) Its own motion, if it is of the opinion that the dispute is likely to substantially interrupt commerce.

The Labor Board may also, upon its own motion, within ten days after a decision has been reached between a carrier and its employees or subordinate officials, suspend the operation of such decision if it is of the opinion that it involves such an increase in wages or salaries as will be likely to necessitate a substantial readjustment of the rates of any carrier, and it may affirm or modify such suspended decision.

Decisions of the Labor Board shall require the concurrence of at least five of the nine members, and in cases of decisions regarding wages or salaries, at least one of the representatives of the public must concur in the decision. Broad powers are vested in the Labor Board with respect to compelling the attendance of witnesses, production of books, documents, etc., and if it has reason to believe that any of its decisions or the decisions of an Adjustment Board are violated by a carrier or its employees, subordinate officials or any organization thereof, it may, after due notice and hearing to all persons directly interested in such violation,

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determine whether in its opinion such violation has occurred, and make public its decision in such manner as it may determine. No penalty is provided for the violation of a decision of the Labor Board.

Prior to September 1, 1920, each carrier is required, under penalty, to pay to each of its employees or subordinate officials wages or salaries at a rate not less than that fixed by any agency, or railway board of adjustment in connection therewith, established for executing the powers granted the President under the Federal Control Act, in effect upon the termination of Federal control.

Amendments to the Interstate Commerce Act.

The Transportation Act, 1920, makes many changes in the Interstate Commerce Act, the most important of which are outlined below. For the details of these changes, the reader is referred to Sections 400-502 of the law, beginning on page 66, of this booklet.

Rates

The Commission is directed to establish rates which will be adequate to provide the carriers as a whole, either in the entire country or in rate groups or territories to be established by the Commission, with an aggregate annual net railway operating income equal as nearly as may be to a fair return upon the aggregate value of the railway property of such carriers held for and used in the service of transportation. The Commission is required, from time to time, to determine and publish the aggregate value of the property of the carriers and to determine what constitutes a fair return

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upon such property, except that for the two years beginning March 1, 1920, it is directed to take as such fair return a sum equal to 5½ per centum of such aggregate value. It may, in its discretion, however, add not more than one-half of one per centum of such aggregate value to make provision for improvements, betterments or equipment chargeable to capital amount. For the purpose of determining the aggregate value of the carriers' property the Commission is directed to give to the property investment accounts, only that consideration to which they are entitled in establishing values for rate-making purposes.

If any carrier earns in any one year a net railway operating income in excess of 6 per centum of the value of the railway property held for and used by it in the service of transportation, one-half of such excess shall be placed in a reserve fund maintained by such carrier, until it equals 5 per centum of the value of the property, and the remainder paid to the Commission for the purpose of maintaining a general contingent fund. When a carrier's reserve fund equals 5 per centum of the value of its railway property, the portion of its excess income, which it is permitted to retain, may be used for any lawful purpose. The general contingent fund referred to above is to be used to make loans to carriers to meet expenditures for capital account and for other purposes described in the law.

Whenever the Commission finds that any rate, fare, charge, classification, regulation, or practice causes any undue or unreasonable advantage, preference, or prejudice as between persons or localities in intrastate commerce, or in interstate or foreign commerce, or any undue, unreasonable, or unjust discrimination against interstate or foreign commerce, it shall prescribe the

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rate, fare, or charge and the classification, regulation, or practice in such manner as in its judgment will remove such advantage, preference, prejudice, or discrimination.

The Commission is authorized to establish just, reasonable, and equitable divisions of joint rates where it finds that existing divisions are unjust, unreasonable, inequitable, or unduly preferential or prejudicial as between the carriers who are parties thereto. While the Commission is empowered to prescribe maximum or minimum, or maximum and minimum rates, fares and charges, it is limited to prescribing maximum rates for through routes in cases where one of the carriers is a water line.

A further amendment to the Interstate Commerce Act provides that if any hearing with respect to rates, classifications, regulations, or practices can not be concluded within the period of suspension provided in Section 15 of the Interstate Commerce Act, as amended, the Commission may extend the time of suspension for a further period not exceeding thirty days, upon the expiration of which the proposed changes shall become effective as of the end of such period, provided the proceeding has not been concluded and an order made at the expiration of such thirty days. In the case of a proposed increase in freight rates the Commission may require that accurate account be kept of all amounts received by reason of such increase, and upon completion of the hearing, may require that such amounts as are found to be excessive shall be refunded to shippers.

Section 418 of the law contains other amendments to Section 15 of the Interstate Commerce Act pertaining to through routes of water carriers, transportation

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of live stock, etc., which may be found on pages 85 to 89 of this booklet.

Consolidations, Mergers, and Pooling

Acquisition by one carrier of the control of another by lease or by purchase of stock or in any other manner not involving the consolidation of such carriers into a single system for ownership and operation, is authorized upon approval by the Commission. Subject to the limitations set forth in Section 407 of the law, the Commission is directed to prepare and adopt a plan for the consolidation of the railway properties of the continental United States into a limited number of systems. Voluntary consolidations or mergers, which are in harmony with the plan as adopted, are permitted, subject to the approval of the Commission and to the requirement that the capital of the consolidated corporation shall not exceed the value of the consolidated properties as determined by the Commission. Division of traffic or earnings may be permitted by the Commission if, in its opinion, it will be in the interest of better service to the public, or economy in operation, and will not unduly restrain competition.

Joint Use of Terminals

The Commission is empowered in its discretion to require the joint or common use of terminals, including main-line track or tracks for a reasonable distance outside of such terminals upon such terms as the carriers may agree upon, or, in the event of their disagreement, as it may find to be just and reasonable.

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Construction and Abandonment of Lines of Railroads

After ninety days from the effective date of the law, no carrier by railroad is permitted to undertake the extension of its lines or the construction of new lines, without having first obtained from the Commission a certificate that public convenience and necessity requires such extension or construction. A certificate is likewise required before a carrier shall acquire or operate any line of railroad or extension thereof, or engage in transportation over or by means of such additional or extended line, or abandon all or any portion of a line of railroad or the operation thereof. The authority of the Commission, as outlined above, does not extend to the construction or abandonment of spur, industrial, team, switching, or side tracks, located wholly within one state, or of street, suburban, or interurban electric railways, which are not operated as a part or parts of a general steam railroad system of transportation.

Security Issues

The Commission is given power to regulate the issue of securities by railroad carriers. After 120 days from the effective date of the Transportation Act, 1920, no carrier is permitted to issue any stocks, bonds, or other securities or to assume any obligation or liability with respect to the securities of any other person, natural or artificial, without the approval of the Commission. This provision does not apply to notes maturing not more than two years after the date thereof, and aggregating (together with all other outstanding notes of a maturity of two years or less) not more than 5 per centum of the par value of the securities of the carrier

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then outstanding, or in the case of securities having no par value, the fair market value as of the date of issue.

Routing of Traffic

Whenever property is diverted or delivered by one carrier to another carrier contrary to routing instructions in the bill of lading, such carriers are made liable to the carrier thus deprived of its right to participate in the haul of the property, for the total amount of the rate or charge it would have received had it participated in the haul. This provision does not apply where the diversion or delivery was in compliance with a lawful order of the Commission; and in cases where the carrier to which the property was diverted had no notice by bill of lading, waybill, or otherwise, of the routing instructions, such carrier shall not be liable.

With respect to traffic not routed by the shipper, whenever the public interest and a fair distribution of the traffic so require, the Commission may direct the route which such traffic shall take after it arrives at the terminus of one carrier or at a junction point with another carrier, and is to be there delivered to another carrier.

Nondiscrimination

The provisions of Section 404 of the Interstate Commerce Act, which prohibits discriminations on the part of common carriers, with respect to charges made for service rendered in the transportation of passengers or property, are made applicable to the transmission of intelligence. As a means of preventing unjust discrimination, all carriers by railroad, on or after July 1, 1920, are prohibited from relinquishing possession at destination of freight transported by them, until all rates and

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charges have been paid, except under such rules and regulations as the Commission may prescribe.

Long and Short Haul

The long and short haul provisions of Section 4 of the Interstate Commerce Act are amended so as to provide that the Commission shall not permit the establishment of any charge to or from the more distant point that is not reasonably compensatory for the service performed. If a circuitous route is permitted to maintain higher rates to or from intermediate points on its line, in order to meet the charges of a more direct line to or from competitive points, such permission shall not include intermediate points as to which the haul of the circuitous route is not longer than that of the direct line or route between the competitive points,

Car Service

An amendment to Section 1 of the Interstate Commerce Act places within the jurisdiction of the Commission the use, control, and supply, as well as the movement, distribution, exchange and interchange of locomotives, cars and other vehicles used in the transportation of property, including special types of equipment, as, for example, refrigerator cars, and the supply of trains. Carriers by rail are required, under penalty, to make just and reasonable distribution of cars for the transportation of coal among the coal mines served by them, and in time of car shortage are required to maintain and apply just and reasonable ratings of such mines and to count each car furnished to or used by any such mine for transportation of coal.

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Increase of Membership of Commission

The membership of the Commission is increased from nine to eleven members and their salaries are increased from $10,000 to $12,000 per annum. The salary of the secretary of the Commission is increased from $5,000 to $7,500 per annum.

Interlocking Directorates

The effective date of Section 10 of the Clayton Anti-Trust Act, prohibiting common directors of carriers and of corporations from which they purchase supplies, is extended until January 1, 1921. This extension, however, does not apply to any corporation organized after January 12, 1918.

After December 31, 1921, all persons are prohibited from being officers or directors of more than one carrier without the consent of the Commission.

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Text of Transportation Act

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Title I.—Definitions

SECTION 1. This Act may be cited as the "Transportation Act, 1920."

SEC. 2. When used in this Act—

The term "Interstate Commerce Act" means the Act entitled "An Act to regulate commerce," approved February 4, 1887, as amended;

The term "Commerce Court Act" means the Act entitled "An Act to create a commerce court, and to amend an Act entitled 'An Act to regulate commerce,' approved February 4, 1887, as heretofore amended, and for other purposes," approved June 18, 1910;

The term "Federal Control Act" means the Act entitled "An Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes," approved March 21, 1918, as amended;

The term "Federal control" means the possession, use, control, and operation of railroads and systems of transportation, taken over or assumed by the President under section 1 of the Act entitled "An Act making appropriations for the support of the Army for the fiscal year ending June 30, 1917, and for other purposes," approved August 29, 1916, or under the Federal Control Act; and

The term "Commission" means the Interstate Commerce Commission.

Title II.—Termination of Federal Control

SEC. 200. (A) Federal control shall terminate at 12.01 a. m., March 1, 1920; and the President shall then relinquish possession and control of all railroads and systems of trans-

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portation then under Federal control and cease the use and operation thereof.

(b) Thereafter the President shall not have or exercise any of the powers conferred upon him by the Federal Control Act relating—

(1) To the use or operation of railroads or systems of transportation;

(2) To the control or supervision of the carriers owning or operating them, or of the business or affairs of such carriers;

(3) To their rates, fares, charges, classifications, regulations, or practices;

(4) To the purchase, construction, or other acquisition of boats, barges, tugs, and other transportation facilities on the inland, canal, or coastwise waterways; or (except in pursuance of contracts or agreements entered into before the termination of Federal control) of terminals, motive power, cars, or equipment, on or in connection with any railroad or system of transportation;

(5) To the utilization or operation of canals;

(6) To the purchase of securities of carriers, except in pursuance of contracts or agreements entered into before the termination of Federal control, or as a necessary or proper incident to the adjustment, settlement, liquidation and winding up of matters arising out of Federal control; or

(7) To the use for any of the purposes above stated (except in pursuance of contracts or agreements entered into before the termination of Federal control, and except as a necessary or proper incident to the winding up or settling of matters arising out of Federal control, and except as provided in section 202) of the revolving fund created by such Act, or of any of the additions thereto made under such Act, or by the Act entitled "An Act to supply a deficiency in the appropriation for carrying out the Act entitled 'An Act to provide for the operation of transporation systems while under Federal control, for the just compensation of their owners, and for other purposes,' approved March 21, 1918," approved June 30, 1919.

(c) Nothing in this Act shall be construed as affecting or limiting the power of the President in time of war (under section 1 of the Act entitled "An Act making appropriations

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for the support of the Army for the fiscal year ending June 30, 1917, and for other purposes," approved August 29, 1916) to take possession and assume control of any system of transportation and utilize the same.

Government-Owned Boats on Inland Waterways

SEC. 201. (a) On the termination of Federal control, as provided in section 200, all boats, barges, tugs, and other transportation facilities, on the inland, canal, and coastwise waterways (hereinafter in this section called "transportation facilities") acquired by the United States in pursuance of the fourth paragraph of section 6 of the Federal Control Act (except the transportation facilities constituting parts of railroads or transportation systems over which Federal control was assumed) are transferred to the Secretary of War, who shall operate or cause to be operated such transportation facilities so that the lines of inland water transportation established by or through the President during Federal control shall be continued, and assume and carry out all contracts and agreements in relation thereto entered into by or through the President in pursuance of such paragraph prior to the time above fixed for such transfer. All payments under the terms of such contracts, and for claims arising out of the operation of such transportation facilities by or through the President prior to the termination of Federal control, shall be made out of moneys available under the provisions of this Act for adjusting, settling, liquidating, and winding up matters arising out of or incident to Federal control. Moneys required for such payments shall, from time to time, be transferred to the Secretary of War as required for payment under the terms of such contracts.

(b) All other payments after such transfer in connection with the construction, utilization, and operation of any such transportation facilities, whether completed or under construction, shall be made by the Secretary of War out of funds now or hereafter made available for that purpose.

(c) The Secretary of War is hereby authorized, out of any moneys hereafter made available therefor, to construct or

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contract for the construction of terminal facilities for the interchange of traffic between the transportation facilities operated by him under this section and other carriers whether by rail or water, and to make loans for such purposes under such terms and conditions as he may determine to any State whose constitution prohibits the ownership of such terminal facilities by other than the State or a political subdivision thereof.

(d) Any transportation facilities owned by the United States and included within any contract made by the United States for operation on the Mississippi River above Saint Louis, the possession of which reverts to the United States at or before the expiration of such contract, shall be operated by the Secretary of War so as to provide facilities for water carriage on the Mississippi River above Saint Louis.

(e) The operation of the transportation facilities referred to in this section shall be subject to the provisions of the Interstate Commerce Act as amended by this Act or by subsequent legislation, and to the provisions of the "Shipping Act, 1916," as now or hereafter amended, in the same manner and to the same extent as if such transportation facilities were privately owned and operated; and all such vessels while operated and employed solely as merchant vessels shall be subject to all other laws, regulations, and liabilities governing merchant vessels, whether the United States is interested therein as owner, in whole or in part, or holds any mortgage, lien, or interest therein. For the performance of the duties imposed by this section the Secretary of War is authorized to appoint or employ such number of experts, clerks, and other employees as may be necessary for service in the District of Columbia or elsewhere, and as may be provided for by Congress.

Settlement of Matters Arising Out of Federal Control

SEC. 202. The President shall, as soon as practicable after the termination of Federal control, adjust, settle, liquidate, and wind up all matters, including compensation, and all questions and disputes of whatsoever nature, arising out of or incident to Federal control. For these purposes and

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for the purpose of making the payments specified in subdivision (a) of section 201, all unexpended balances in the revolving fund created by the Federal Control Act or of the moneys appropriated by the Act entitled "An Act to supply a deficiency in the appropriation for carrying out the Act entitled 'An Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes,' approved March 21, 1918," approved June 30, 1919, are hereby reappropriated and made available until expended; and all moneys derived from the operation of the carriers or otherwise arising out of Federal control, and all moneys that have been or may be received in payment of the indebtedness of any carrier to the United States arising out of Federal control, shall be and remain available until expended for the aforesaid purposes; and there is hereby appropriated for the aforesaid purposes, out of any money in the Treasury not otherwise appropriated, $200,000,000 in addition to the above, to be available until expended.

Compensation of Carriers With Which No Contract Made

SEC. 203. (a) Upon the request of any carrier entitled to just compensation under the Federal Control Act, but with which no contract fixing or waiving compensation has been made and which has made no waiver of compensation, the President: (1) shall pay to it so much of the amount he may determine to be just compensation as may be necessary to enable such carrier to have the sums required for interest, taxes, and other corporate charges and expenses referred to in paragraph (b) of section 7 of the standard contract between the United States and the carriers, accruing during the period for which such carrier is entitled to just compensation under the Federal Control Act, and also the sums required for dividends declared and paid during the same period, including, also, in addition, a sum equal to that proportion of such last dividend which the period between its payment and the termination of the period for which the carrier is entitled to just compensation under the Federal Control Act bears to the last dividend period; and (2) may,

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in his discretion, pay to such carrier the whole or any part of the remainder of such estimated amount of just compensation.

(b) The acceptance of any benefits by a carrier under this section—

(1) shall not deprive it of the right to claim additional compensation, which, unless agreed upon, shall be ascertained in the manner provided in section 3 of the Federal Control Act; but

(2) shall constitute an acceptance by the carrier of all the provisions of the Federal Control Act as modified by this Act, and obligate the carrier to pay to the United States with interest at the rate of 6 per centum per annum from a date or dates fixed in proceedings under section 3 of the Federal Control Act, the amount by which the sums received on account of such compensation, under this section or otherwise, exceed the sum found due in such proceedings.

Reimbursement of Deficits During Federal Control

SEC. 204. (a) When used in this section—

The term "carrier" means a carrier by railroad which during any part of the period of Federal control, engaged as a common carrier in general transportation, and competed for for traffic, or connected, with a railroad under Federal control, and which sustained a deficit in its railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation; but does not include any street or interurban electric railway which has as its principal source of operating revenue urban, suburban, or interurban passenger traffic or sale of power, heat, and light, or both; and

The term "test period" means the three years ending June 30, 1917.

(b) For the purposes of this section—

Railway operating income or any deficit therein for the period of Federal control shall be computed in a manner similar to that provided in section 209 with respect to such income or deficit for the guaranty period; and

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Railway operating income or any deficit therein for the test period shall be computed in the manner provided in section 1 of the Federal Control Act.

(c) As soon as practicable after March 1, 1920, the Commission shall ascertain for every carrier, for every month of the period of Federal control during which its railroad or system of transportation was not under Federal operation, its deficit in railway operating income, if any, and its railway operating income, if any (hereinafter called "Federal control return"), and the average of its deficit in railway operating income, if any, and of its railway operating income, if any, for the three corresponding months of the test period taken together, (herinafter called "test period return"): *Provided*, That "test period return," in the case of a carrier which operated its railroad or system of transportation for at least one year during, but not for the whole of, the test period, means its railway operating income, or the deficit therein, for the corresponding month during the test period, or the average thereof for the corresponding months during the test period taken together, during which the carrier operated its railroad or system of transportation.

(d) For every month of the period of Federal control during which the railroad or system of transportation of the carrier was not under Federal operation, the Commission shall then ascertain (1) the difference between its Federal control return, if a deficit, and its test period return, if a smaller deficit, or (2) the difference between its test period return, if an income, and its Federal control return, if a smaller income, or (3) the sum of its Federal control return, if a deficit, plus its test period return, if an income. The sum of such amounts shall be credited to the carrier.

(e) For every such month the Commission shall then ascertain (1) the difference between the carrier's Federal control return, if an income, and its test period return, if a smaller income, or (2) the difference between its test period return, if a deficit, and its Federal control return, if a smaller deficit, or (3) the sum of its Federal control return, if an income, plus its test period return, if a deficit. The sum of such amounts shall be credited to the United States.

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(f) If the sum of the amounts so credited to the carrier under subdivision (d) exceeds the sum of the amounts so credited to the United States under subdivision (e), the difference shall be payable to the carrier. In the case of a carrier which operated its railroad or system of transportation for less than a year during, or for none of, the test period, the foregoing computations shall not be used, but there shall be payable to such carrier its deficit in railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation.

(g) The Commission shall promptly certify to the Secretary of the Treasury the several amounts payable to carriers under paragraph (f). The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States for the amount shown in such certificate as payable thereto. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated.

Inspection of Carriers' Records

SEC. 205. The President shall have the right, at all reasonable times until the affairs of Federal control are concluded, to inspect the property and records of all carriers whose railroads or systems of transportation were at any time under Federal control, whenever such inspection is necessary or appropriate (1) to protect the interests of the United States, or (2) to supervise matters being handled for the United States by agents of the carriers, or (3) to secure information concerning matters arising during Federal control, and such carriers shall provide all reasonable facilities therefor, including the issuance of free transportation to all agents of the President while traveling on official business for these purposes.

Such carriers shall, at their expense, upon the request of the President, or those duly authorized by him, furnish all necessary and proper information and reports compiled from the records made or kept during the period of Federal control affecting their respective lines, and shall keep and continue

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such records and furnish like information and reports compiled therefrom.

Any carrier which refuses or obstructs such inspection, or which willfully fails to provide reasonable facilities therefor, or to furnish such information or reports shall be liable to a penalty of $500 for each day of the continuance of such offense, which shall accrue to the United States and may be recovered in a civil action to be brought by the United States.

Causes of Action Arising Out of Federal Control

SEC. 206. (a) Actions at law, suits in equity and proceedings in admiralty, based on causes of action arising out of the possession, use, or operation by the President of the railroad or system of transportation of any carrier (under the provisions of the Federal Control Act, or of the Act of August 29, 1916) of such character as prior to Federal control could have been brought against such carrier, may, after the termination of Federal control, be brought against an agent designated by the President for such purpose, which agent shall be designated by the President within thirty days after the passage of this Act. Such actions, suits, or proceedings may, within the periods of limitation now prescribed by State or Federal statutes but not later than two years from the date of the passage of this Act, be brought in any court which but for Federal control would have had jurisdiction of the cause of action had it arisen against such carrier.

(b) Process may be served upon any agent or officer of the carrier operating such railroad or system of transportation, if such agent or officer is authorized by law to be served with process in proceedings brought against such carrier and if a contract has been made with such carrier by or through the President for the conduct of litigation arising out of operation during Federal control. If no such contract has been made process may be served upon such agents or officers as may be designated by or through the President. The agent designated by the President under subdivision (a) shall cause to be filed, upon the termination of Federal control.

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in the office of the Clerk of each District Court of the United States, a statement naming all carriers with whom he has contracted for the conduct of litigation arising out of operation during Federal control, and a like statement designating the agents or officers upon whom process may be served in actions, suits, and proceedings arising in respect to railroads or systems of transportation with the owner of which no such contract has been made; and such statements shall be supplemented from time to time, if additional contracts are made or other agents or officers appointed.

(c) Complaints praying for reparation on account of damage claimed to have been caused by reason of the collection or enforcement by or through the President during the period of Federal control of rates, fares, charges, classifications, regulations, or practices (including those applicable to interstate, foreign or intrastate traffic) which were unjust, unreasonable, unjustly discriminatory, or unduly or unreasonably prejudicial, or otherwise in violation of the Interstate Commerce Act, may be filed with the Commission, within one year after the termination of Federal control, against the agent designated by the President under subdivision (a), naming in the petition the railroad or system of transportation against which such complaint would have been brought if such railroad or system had not been under Federal control at the time the matter complained of took place. The Commission is hereby given jurisdiction to hear and decide such complaints in the manner provided in the Interstate Commerce Act, and all notices and orders in such proceedings shall be served upon the agent designated by the President under subdivision (a).

(d) Actions, suits, proceedings, and reparation claims, of the character above described pending at the termination of Federal control shall not abate by reason of such termination, but may be prosecuted to final judgment, substituting the agent designated by the President under subdivision (a).

(e) Final judgments, decrees, and awards in actions, suits, proceedings, or reparation claims, of the character above described, rendered against the agent designated by the President under subdivision (a), shall be promptly paid out of the revolving fund created by section 210.

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(f) The period of Federal control shall not be computed as a part of the periods of limitation in action against carriers or in claims for reparation to the Commission for causes of action arising prior to Federal control.

(g) No execution or process, other than on a judgment recovered by the United States against a carrier, shall be levied upon the property of any carrier where the cause of action on account of which the judgment was obtained grew out of the possession, use, control, or operation of any railroad or system of transportation by the President under Federal control.

Refunding of Carriers' Indebtedness to United States

SEC. 207. (a) As soon as practicable after the termination of Federal control the President shall ascertain (1) the amount of the indebtedness of each carrier to the United States, which may exist at the termination of Federal control, incurred for additions and betterments made during Federal control and properly chargeable to capital account; (2) the amount of indebtedness of such carrier to the United States otherwise incurred; and (3) the amount of the indebtedness of the United States to such carrier arising out of Federal control. The amount under clause (3) may be set off against either or both of the amounts under clauses (1) and (2), so far as deemed wise by the President, but only to the extent permitted under any contract now or hereafter made between such carrier and the United States in respect to the matters of Federal control, or, where no such contract exists, to the extent permitted under paragraph (b) of section 7 of the standard contract between the United States and the carriers relative to deductions from compensation; *Provided*, That such right of set-off shall not be so exercised as to prevent such carrier from having the sums required for interest, taxes, and other corporate charges and expenses referred to in paragraph (b) of section 7 of such standard contract, accruing during Federal control, and also the sums required for dividends declared and paid during Federal control, including, also in addition, a sum equal to that proportion of such last dividend which the period between its

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payment and the termination of Federal control bears to the last regular dividend period: *And provided further*, That such right of set-off shall not be exercised unless there shall have first been paid such sums in addition as may be necessary to provide the carrier with working capital in amount not less than one twenty-fourth of its operating expenses for the calendar year 1919.

(b) Any remaining indebtedness of the carrier to the United States in respect to such additions and betterments shall, at the request of the carrier, be funded for a period of ten years from the termination of Federal control, or a shorter period at the option of the carrier, with interest at the rate of 6 per centum per annum, payable semiannually, subject to the right of such carrier to pay, on any interest-payment day, the whole or any part of such indebtedness. Any carrier obtaining the funding of such indebtedness as aforesaid shall give, in the discretion of the President, such security, in such form and upon such terms, as he may prescribe.

(c) If the President and the various carriers, or any of them, shall enter into an agreement for funding, through the medium of car trust certificates, or otherwise, the indebtedness of any such carrier to the United States incurred for equipment ordered for the benefit of such carrier, such indebtedness so funded shall not be refundable under the foregoing provisions.

(d) Any other indebtedness of any such carrier to the United States which may exist after the settlement of accounts between the United States and the carrier and is then due shall be evidenced by notes payable in one year from the termination of Federal control, or a shorter period at the option of the carrier, with interest at the rate of 6 per centum per annum, and secured by such collateral security as the President may deem it advisable to require.

(e) With respect to any bonds, notes, or other securities, acquired under the provisions of this section or of the Federal Control Act or of the Act entitled "An Act to provide for the reimbursement of the United States for motive power, cars and other equipment ordered for railroads and systems of transportation under Federal control, and for other pur-

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poses," approved November 19, 1919, the President shall have the right to make such arrangements for extension of the time of payment or for for the exchange of any of them for other securities, or partly for cash and partly for securities, as may be provided for in any agreement entered into by him or as may in his judgment seem desirable.

(f) Carriers may, by agreement with the President, issue notes or other evidences of indebtedness, secured by equipment trust agreements, for equipment purchased during Federal control by or through the President under section 6 of the Federal Control Act, and allocated to such carriers respectively; and the filing of such equipment trust agreements with the Commission shall constitute notice thereof to all the world.

(g) A carrier may issue evidences of indebtedness pursuant to this section without the authorization or approval of any authority, State or Federal, and without compliance with any requirement, State or Federal, as to notification.

Existing Rates to Continue in Effect

SEC. 208. (a) All rates, fares, and charges, and all classifications, regulations, and practices, in any wise changing, affecting, or determining, any part of the aggregate of rates, fares, or charges, or the value of the service rendered, which on February 29, 1920, are in effect on the lines of carriers subject to the Interstate Commerce Act, shall continue in force and effect until thereafter changed by State or Federal authority, respectively, or pursuant to authority of law; but prior to September 1, 1920, no such rate, fare, or charge shall be reduced, and no such classification, regulation, or practice shall be changed in such manner as to reduce any such rate, fare, or charge, unless such reduction or change is approved by the Commission.

(b) All divisions of joint rates, fares, or charges, which on February 29, 1920, are in effect between the lines of carriers subject to the Interstate Commerce Act, shall continue in force and effect until thereafter changed by mutual agreement between the interested carriers or by State or Federal authorities, respectively.

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(c) Any land grant railroad organized under the Act of July 28, 1866 (chapter 300), shall receive the same compensation for transportation of property and troops of the United States as is paid to land grant railroads organized under the Land Grant Act of March 3, 1863, and the Act of July 27, 1866 (chapter 278).

Guaranty to Carriers After Termination of Federal Control

SEC. 209. (a) When used in this section—

The term "carrier" means (1) a carrier by railroad or partly by railroad and partly by water, whose railroad or system of transportation is under Federal control at the time Federal control terminates, or which has heretofore engaged as a common carrier in general transportation and competed for traffic, or connected, with a railroad at any time under Federal control; and (2) a sleeping car company whose system of transportation is under Federal control at the time Federal control terminates; but does not include a street or interurban electric railway not under Federal control at the time Federal control terminates, which has as its principal source of operating revenue urban, suburban, or interurban passenger traffic or sale of power, heat, and light, or both;

The term "guaranty period" means the six months beginning March 1, 1920.

The term "test period" means the three years ending June 30, 1917; and

The term "railway operating income" and other references to accounts of carriers by railroad shall, in the case of a sleeping car company, be construed as indicating the appropriate corresponding accounts in the accounting system prescribed by the Commission.

(b) This section shall not be applicable to any carrier which does not on or before March 15, 1920, file with the Commission a written statement that it accepts all the provisions of this section.

(c) The United States hereby guarantees—

(1) With respect to any carrier with which a contract (exclusive of so-called cooperative contracts or waivers) has been made fixing the amount of just compensation under

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the Federal Control Act, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half the amount named in such contract as annual compensation, or, where the contract fixed a lump sum as compensation for the whole period of Federal operation, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than an amount which shall bear the same proportion to the lump sum so fixed as six months bears to the number of months during which such carrier was under Federal operation, including in both cases the increases in such compensation provided for in section 4 of the Federal Control Act;

(2) With respect to any carrier entitled to just compensation under the Federal Control Act, with which such a contract has not been made, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half of the annual amount estimated by the President as just compensation for such carrier under the Federal Control Act, including the increases in such compensation provided for in section 4 of the Federal Control Act. If any such carrier does not accept the President's estimate respecting its just compensation, and if in proceedings under section 3 of the Federal Control Act it is determined that a larger or smaller annual amount is due as just compensation, the guaranty under this paragraph shall be increased or decreased accordingly;

(3) With respect to any carrier, whether or not entitled to just compensation under the Federal Control Act, with which such a contract has not been made, and for which no estimate of just compensation is made by the President, and which for the test period as a whole sustained a deficit in railway operating income, the guaranty shall be a sum equal to (a) the amount by which any deficit in its railway operating income for the guaranty period as a whole exceeds one-half of its average annual deficit in railway operating income for the test period, plus (b) an amount equal to one-half the annual sum fixed by the President under section 4 of the Federal Control Act;

(4) With respect to any carrier not entitled to just compensation under the Federal Control Act, which for the

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test period as a whole had an average annual railway operating income, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half the average annual railway operating income of such carrier during the test period.

(d) If for the guaranty period as a whole the railway operating income of any carrier entitled to a guaranty under paragraph (1), (2), or (4) of subdivision (c) is in excess of the minimum railway operating income guaranteed in such paragraph, such carrier shall forthwith pay the amount of such excess into the Treasury of the United States. If for the guaranty period as a whole the railway operating income of any carrier entitled to a guaranty under paragraph (3) of subdivision (c) is in excess of one-half of the annual sum fixed by the President with respect to such carrier under section 4 of the Federal Control Act, such carrier shall forthwith pay the amount of such excess into the Treasury of the United States. The amounts so paid into the Treasury of the United States shall be added to the funds made available under section 202 for the purposes indicated in such section. Notwithstanding the provisions of this subdivision, any carrier may retain out of any such excess any amount necessary to enable it to pay its fixed charges accruing during the guaranty period.

(e) For the purposes of this section railway operating income, or any deficit therein, for the test period shall be computed in the manner provided for in section 1 of the Federal Control Act.

(f) In computing railway operating income, or any deficit therein, for the guaranty period for the purposes of this section—

(1) Debits and credits arising from the accounts, called in the monthly reports to the Commission equipment rents and joint facility rents, shall be included, but debits and credits arising from the operation of such street electric passenger railways, including railways commonly called interurbans, as are not under Federal control at the time of termination thereof, shall be excluded;

(2) Proper adjustments shall be made (a) in case any lines which were, during any portion of the period of Federal

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control, a part of the railroad or system of transportation of the carrier, and whose railway operating income was included in such income of the carrier for the test period, do not continue to be a part of such railroad or system of transportation during the entire guaranty period, and (b) in case of any lines acquired by, leased to, or consolidated with, the railroad or system of transportation of the carrier at any time since the end of the test period and prior to the expiration of the guaranty period, for which separate operating returns to the Commission are not made in respect to the entire portion of the guaranty period;

(3) There shall not be included in operating expenses, for maintenance of way and structures, or for maintenance of equipment, more than an amount fixed by the Commission. In fixing such amount the Commission shall so far as practicable apply the rule set forth in the proviso in paragraph (a) of section 5 of the "standard contract" between the United States and the carriers (whether or not such contract has been entered into with the carrier whose railway operating income is being computed);

(4) There shall not be included any taxes paid under Title I or II of the Revenue Act of 1917, or such portion of the taxes paid under Title II or III of the Revenue Act of 1918 as by the terms of such Act are to be treated as levied by an Act in amendment of Title I or II of the Revenue Act of 1917; and

(5) The Commission shall require the elimination and restatement of the operating expenses and revenues (other than for maintenance of way and structures, or maintenance of equipment) for the guaranty period, to the extent necessary to correct and exclude any disproportionate or unreasonable charge to such expenses or revenues for such period, or any charge to such expenses or revenues for such period which under a proper system of accounting is attributable to another period.

(g) The Commission shall, as soon as practicable after the expiration of the guaranty period, ascertain and certify to the Secretary of the Treasury the several amounts necessary to make good the foregoing guaranty to each carrier. The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such

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carrier upon the Treasury of the United States, for the amount shown in such certificate as necessary to make good such guaranty. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated.

(h) Upon application of any carrier to the Commission, asking that during the guaranty period there may be advanced to it from time to time such sums, not in excess of the estimated amount necessary to make good the guaranty, as are necessary to enable it to meet its fixed charges and operating expenses, the Commission may certify to the Secretary of the Treasury the amount of, and times at which, such advances, if any, shall be made. The Secretary of the Treasury, on receipt of such certificate, is authorized and directed to make the advances in the amounts and at the times specified in the certificate, upon the execution by the carrier of a contract, secured in such manner as the Secretary may determine, that upon final determination of the amount of the guaranty provided for by this section such carrier will repay to the United States any amounts which it has received from such advances in excess of the guaranty, with interest at the rate of 6 per centum per annum from the time such excess was paid. There is hereby appropriated, out of any money in the Treasury not otherwise appropriated, a sum sufficient to enable the Secretary of the Treasury to make the advances referred to in this subdivision.

(i) If the American Railway Express Company shall, on or before March 15, 1920, file with the Commission a written statement that it accepts all the provisions of this subdivision, the contract of June 26, 1918, between such company and the Director General of Railroads, as amended and continued by agreement dated November 21, 1918, shall remain in full force and effect during the guaranty period in so far as the same constitutes a guaranty on the part of the United States to such company against a deficit in operating income.

In computing operating income, and any deficit therein, for the guaranty period for the purposes of this subdivision, the Commission shall require the elimination and restatement of the operating expenses and revenues for the guaranty period, to the extent necessary to correct and exclude any disproportionate or unreasonable charge to such expenses or revenues

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for such period, or any charge to such expenses or revenues for such period which under a proper system of accounting is attributable to another period, and to exclude from operating expenses so much of the charge for payment for express privileges to carriers on whose lines the express traffic is carried as is in excess of 50.25 per centum of gross express revenue.

For the guaranty period the American Railway Express Company shall pay to every carrier which accepts the provisions of this section, as provided in subdivision (b) hereof, 50.25 per centum of the gross revenue earned on the transportation of all its express traffic on the carrier's lines, and every such carrier shall accept from the American Railway Express Company such percentage of the gross revenue as its compensation. In arriving at the gross revenue on through or joint express traffic, the method of dividing the revenue between the carriers shall be that agreed upon between the carriers and such express company and approved by the Commission.

If for the guaranty period as a whole the American Railway Express Company does not have a deficit in operating income, it shall forthwith pay the amount of its operating income for such period into the Treasury of the United States. The amount so paid shall be added to the funds made available under section 202 for the purposes indicated in such section.

The Commission shall, as soon as practicable after the expiration of the guaranty period, certify to the Secretary of the Treasury the amount necessary to make good the foregoing guaranty to the American Railway Express Company. The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of such company upon the Treasury of the United States for the amount shown in such certificate as necessary to make good such guaranty. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated.

Upon application of the American Railway Express Company to the Commission, asking that during the guaranty period there may be advanced to it from time to time such sums, not in excess of the estimated amount necessary to make good the guaranty, as are necessary to enable it to

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meet its operating expenses, the Commission may certify to the Secretary of the Treasury the amount of, and times at which, such advances, if any, shall be made. The Secretary of the Treasury, on receipt of such certificate, is authorized and directed to make the advances in the amounts and at the times specified in the certificate, upon the execution by such company of a contract, secured in such manner as the Secretary may determine, that upon final determination of the amount of the guaranty provided for by this subdivision such company will repay to the United States any amounts which it has received from such advances in excess of the guaranty, with interest at the rate of 6 per centum per annum from the time such excess was paid. There is hereby appropriated out of any money in the Treasury not otherwise appropriated a sum sufficient to enable the Secretary of the Treasury to make the advances referred to in this subdivision.

New Loans to Railroads

SEC. 210. (a) For the purpose of enabling carriers by railroad subject to the Interstate Commerce Act properly to serve the public during the transition period immediately following the termination of Federal control, any such carrier may, at any time after the passage of this Act and before the expiration of two years after the termination of Federal control, make application to the Commission for a loan from the United States, setting forth the amount of the loan and the term for which it is desired, the purpose of the loan and the uses to which it will be applied, the present and prospective ability of the applicant to repay the loan and meet the requirements of its obligations in that regard, the character and value of the security offered, and the extent to which the public convenience and necessity will be served. The application shall be accompanied by statements showing such facts and details as the Commission may require with respect to the physical situation, ownership, capitalization, indebtedness, contract obligations, operation, and earning power of the applicant, together with such other facts relating to the propriety and expediency of granting the loan applied for and the ability of the applicant to make good the obligation, as the Commission may deem pertinent to the inquiry.

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(b) If the Commission, after such hearing and investigation, with or without notice, as it may direct, finds that the making, in whole or in part, of the proposed loan by the United States is necessary to enable the applicant properly to meet the transportation needs of the public, and that the prospective earning power of the applicant and the character and value of the security offered are such as to furnish reasonable assurance of the applicant's ability to repay the loan within the time fixed therefor, and to meet its other obligations in connection with such loan, the Commission may certify to the Secretary of the Treasury its findings of fact and its recommendations as to: the amount of the loan which is to be made; the time, not exceeding five years from the making thereof, within which it is to be repaid; the character of the security which is to be offered therefor; and the terms and conditions of the loan.

(c) Upon receipt of such certificate from the Commission, the Secretary of the Treasury, at any time before the expiration of twenty-six months after the termination of Federal control, is authorized to make a loan, not exceeding the maximum amount recommended in such certificate, out of any moneys in the revolving fund provided for in this section. All such loans shall bear interest at the rate of 6 per centum per annum, payable semiannually to the Secretary of the Treasury and to be placed to the credit of the revolving fund provided for in this section. The time, not exceeding five years from the making thereof, within which such loan is to be repaid, the security which is to be taken therefor, which shall be adequate to secure the loan, the terms and conditions of the loan, and the form of the obligation to be entered into, shall be prescribed by the Secretary of the Treasury.

(d) The Commission or the Secretary of the Treasury may call upon the Federal Reserve Board for advice and assistance with respect to any such application or loan.

(e) There is hereby appropriated out of any moneys in the Treasury not otherwise appropriated the sum of $300,000,000, which shall be used as a revolving fund for the purpose of making the loans provided for in this section, and for paying the judgments, decrees, and awards referred to in subdivision (e) of section 206.

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(f) A carrier may issue evidences of indebtedness to the United States pursuant to this section without the authorization or approval of any authority, State or Federal, and without compliance with any requirement, State or Federal, as to notification.

Execution of Powers of President

SEC. 211. All powers and duties conferred or imposed upon the President by the preceding sections of this Act, except the designation of the agent under section 206, may be executed by him through such agency or agencies as he may determine.

Title III.—Disputes Between Carriers and Their Employees and Subordinate Officials

Sec. 300. When used in this title—

(1) The term "carrier" includes any express company, sleeping car company, and any carrier by railroad, subject to the Interstate Commerce Act, except a street, interurban, or suburban electric railway not operating as a part of a general steam railroad system of transportation;

(2) The term "Adjustment Board" means any Railroad Board of Labor Adjustment established under section 302;

(3) The term "Labor Board" means the Railroad Labor Board;

(4) The term "commerce" means commerce among the several States or between any State, Territory, or the District of Columbia and any foreign nation, or between any Territory or the District of Columbia and any State, or between any Territory and any other Territory, or between any Territory and the District of Columbia, or within any Territory or the District of Columbia, or between points in the same State but through any other State or any Territory or the District of Columbia or any foreign nation; and

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(5) The term "subordinate official" includes officials of carriers of such class or rank as the Commission shall designate by regulation formulated and issued after such notice and hearing as the Commission may prescribe, to the carriers, and employees and subordinate officials of carriers, and organizations thereof, directly to be affected by such regulations.

SEC. 301. It shall be the duty of all carriers and their officers, employees, and agents to exert every reasonable effort and adopt every available means to avoid any interruption to the operation of any carrier growing out of any dispute between the carrier and the employees or subordinate officials thereof. All such disputes shall be considered and, if possible, decided in conference between representatives designated and authorized so to confer by the carriers, or the employees or subordinate officials thereof, directly interested in the dispute. If any dispute is not decided in such conference, it shall be referred by the parties thereto to the board which under the provisions of this title is authorized to hear and decide such dispute.

SEC. 302. Railroad Boards of Labor Adjustment may be established by agreement between any carrier, group of carriers, or the carriers as a whole, and any employees or subordinate officials of carriers, or organization or group of organizations thereof.

SEC. 303. Each such Adjustment Board shall, (1) upon the application of the chief executive of any carrier or organization of employees or subordinate officials whose members are directly interested in the dispute, (2) upon the written petition signed by not less than 100 unorganized employees or subordinate officials directly interested in the dispute, (3) upon the Adjustment Board's own motion, or (4) upon the request of the Labor Board whenever such board is of the opinion that the dispute is likely substantially to interrupt commerce, receive for hearing, and as soon as practicable and with due diligence, decide any dispute involving only grievances, rules, or working conditions, not decided as provided in section 301, between the carrier and its employees or subordinate officials, who are, or any organization thereof which is, in accordance with the provisions of section 302, represented upon any such Adjustment Board.

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SEC. 304. There is hereby established a board to be known as the "Railroad Labor Board" and to be composed of nine members as follows:

(1) Three members constituting the labor group, representing the employees and subordinate officials of the carriers, to be appointed by the President, by and with the advice and consent of the Senate, from not less than six nominees whose nominations shall be made and offered by such employees in such manner as the Commission shall by regulation prescribe;

(2) Three members, constituting the management group, representing the carriers, to be appointed by the President, by and with the advice and consent of the Senate, from not less than six nominees whose nominations shall be made and offered by the carriers in such manner as the Commission shall by regulation prescribe; and

(3) Three members, constituting the public group, representing the public, to be appointed directly by the President, by and with the advice and consent of the Senate.

Any vacancy on the Labor Board shall be filled in the same manner as the original appointment.

SEC. 305. If either the employees or the carriers fail to make nominations and offer nominees in accordance with the regulations of the Commission, as provided in paragraphs (1) and (2) of section 304, within thirty days after the passage of this Act in case of any original appointment to the office of member of the Labor Board, or in case of a vacancy in any such office within fifteen days after such vacancy occurs, the President shall thereupon directly make the appointment, by and with the advice and consent of the Senate. In making any such appointment the President shall, as far as he deems it practicable, select an individual associated in interest with the carriers or employees thereof, whichever he is to represent.

SEC. 306. (a) Any member of the Labor Board who during his term of office is an active member or in the employ of or holds any office in any organization of employees or subordinate officials, or any carrier, or owns any stock or bond thereof, or is pecuniarily interested therein, shall at once become ineligible for further membership upon the Labor Board; but no such member is required to relinquish honorary member-

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ship in, or his rights in any insurance or pension or other benefit fund maintained by, any organization of employees or subordinate officials or by a carrier.

(b) Of the original members of the Labor Board, one from each group shall be appointed for a term of three years, one for two years, and one for one year. Their successors shall hold office for terms of five years, except that any member appointed to fill a vacancy shall be appointed only for the unexpired term of the member whom he succeeds. Each member shall receive from the United States an annual salary of $10,000. A member may be removed by the President for neglect of duty or malfeasance in office, but for no other cause.

SEC. 307. (a) The Labor Board shall hear, and as soon as practicable and with due diligence decide, any dispute involving grievances, rules, or working conditions, in respect to which any Adjustment Board certifies to the Labor Board that in its opinion the Adjustment Board has failed or will fail to reach a decision within a reasonable time, or in respect to which the Labor Board determines that any Adjustment Board has so failed or is not using due diligence in its consideration thereof. In case the appropriate Adjustment Board is not organized under the provisions of section 302, the Labor Board, (1) upon the application of the chief executive of any carrier or organization of employees or subordinate officials whose members are directly interested in the dispute, (2) upon a written petition signed by not less than 100 unorganized employees or subordinate officials directly interested in the dispute, or (3) upon the Labor Board's own motion if it is of the opinion that the dispute is likely substantially to interrupt commerce, shall receive for hearing, and as soon as practicable and with due diligence decide, any dispute involving grievances, rules, or working conditions which is not decided as provided in section 301 and which such Adjustment Board would be required to receive for hearing and decision under the provisions of section 303.

(b) The Labor Board, (1) upon the application of the chief executive of any carrier or organization of employees or subordinate officials whose members are directly interested in the dispute, (2) upon a written petition signed by not less than 100 unorganized employees or subordinate officials directly interested in the dispute, or (3) upon the Labor

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Board's own motion if it is of the opinion that the dispute is likely substantially to interrupt commerce, shall receive for hearing, and as soon as practicable and with due diligence decide, all disputes with respect to the wages or salaries of employees or subordinate officials of carriers, not decided as provided in section 301. The Labor Board may upon its own motion within ten days after the decision, in accordance with the provisions of section 301, of any dispute with respect to wages or salaries of employees or subordinate officials of carriers, suspend the operation of such decision if the Labor Board is of the opinion that the decision involves such an increase in wages or salaries as will be likely to necessitate a substantial readjustment of the rates of any carrier. The Labor Board shall hear any decision so suspended and as soon as practicable and with due diligence decide to affirm or modify such suspended decision.

(c) A decision by the Labor Board under the provisions of paragraphs (a) or (b) of this section shall require the concurrence therein of at least 5 of the 9 members of the Labor Board: *Provided*, That in case of any decision under paragraph (b), at least one of the representatives of the public shall concur in such decision. All decisions of the Labor Board shall be entered upon the records of the board and copies thereof, together with such statement of facts bearing thereon as the board may deem proper, shall be immediately communicated to the parties to the dispute, the President, each Adjustment Board, and the Commission, and shall be given further publicity in such manner as the Labor Board may determine.

(d) All the decisions of the Labor Board in respect to wages or salaries and of the Labor Board or an Adjustment Board in respect to working conditions of employees or subordinate officials of carriers shall establish rates of wages and salaries and standards of working conditions which in the opinion of the board are just and reasonable. In determining the justness and reasonableness of such wages and salaries or working conditions the board shall, so far as applicable, take into consideration among other relevant circumstances:

(1) The scales of wages paid for similar kinds of work in other industries;

(2) The relation between wages and the cost of living;

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(3) The hazards of the employment;
(4) The training and skill required;
(5) The degree of responsibility;
(6) The character and regularity of the employment; and
(7) Inequalities of increases in wages or of treatment, the result of previous wage orders or adjustments.

SEC. 308. The Labor Board—

(1) Shall elect a chairman by majority vote of its members;

(2) Shall maintain central offices in Chicago, Illinois, but the Labor Board may, whenever it deems it necessary, meet at such other place as it may determine;

(3) Shall investigate and study the relations between carriers and their employees, particularly questions relating to wages, hours of labor, and other conditions of employment and the respective privileges, rights, and duties of carriers and employees, and shall gather, compile, classify, digest, and publish, from time to time, data and information relating to such questions to the end that the Labor Board may be properly equipped to perform its duties under this title and that the members of the Adjustment Boards and the public may be properly informed;

(4) May make regulations necessary for the efficient execution of the functions vested in it by this title; and

(5) Shall at least annually collect and publish the decisions and regulations of the Labor Board and the Adjustment Boards and all court and administrative decisions and regulations of the Commission in respect to this title, together with a cumulative index-digest thereof.

SEC. 309. Any party to any dispute to be considered by an Adjustment Board or by the Labor Board shall be entitled to a hearing either in person or by counsel.

SEC. 310. (a) For the efficient administration of the functions vested in the Labor Board by this title, any member thereof may require, by subpœna issued and signed by himself, the attendance of any witness and the production of any book, paper, document, or other evidence from any place in the United States at any designated place of hearing, and the taking of a deposition before any designated person having power to administer oaths. In the case of a deposition the testimony shall be reduced to writing by the person taking

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the deposition or under his direction, and shall then be subscribed to by the deponent. Any member of the Labor Board may administer oaths and examine any witness. Any witness summoned before the board and any witness whose deposition is taken shall be paid the same fees and mileage as are paid witnesses in the courts of the United States.

(b) In case of failure to comply with any subpœna or in case of the contumacy of any witness appearing before the Labor Board, the board may invoke the aid of any United States district court. Such court may thereupon order the witness to comply with the requirements of such subpœna, or to give evidence touching the matter in question, as the case may be. Any failure to obey such order may be punished by such court as a contempt thereof.

(c) No person shall be excused from so attending and testifying or deposing, nor from so producing any book, paper, document, or other evidence on the ground that the testimony or evidence, documentary or otherwise, required of him may tend to incriminate him or subject him to a penalty or forfeiture; but no natural person shall be prosecuted or subjected to any penalty or forfeiture for or on account of any transaction, matter, or thing, as to which in obedience to a subpœna and under oath, he may so testify or produce evidence, documentary or otherwise. But no person shall be exempt from prosecution and punishment for perjury committed in so testifying.

SEC. 311. (a) When necessary to the efficient administration of the functions vested in the Labor Board by this title, any member, officer, employee, or agent thereof, duly authorized in writing by the board, shall at all reasonable times for the purpose of examination have access to and the right to copy any book, account, record, paper, or correspondence relating to any matter which the board is authorized to consider or investigate. Any person who upon demand refuses any duly authorized member, officer, employee, or agent of the Labor Board such right of access or copying, or hinders, obstructs, or resists him in the exercise of such right, shall upon conviction thereof be liable to a penalty of $500 for each such offense. Each day during any part of which such offense continues shall constitute a separate offense. Such penalty

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shall be recoverable in a civil suit brought in the name of the United States, and shall be covered into the Treasury of the United States as miscellaneous receipts.

(b) Every officer or employee of the United States, whenever requested by any member of the Labor Board or an Adjustment Board duly authorized by the board for the purpose, shall supply to such board any data or information pertaining to the administration of the functions vested in it by this title, which may be contained in the records of his office.

(c) The President is authorized to transfer to the Labor Board any books, papers, or documents pertaining to the administration of the functions vested in the board by this title, which are in the possession of any agency, or railway board of adjustment in connection therewith, established for executing the powers granted the President under the Federal Control Act and which are no longer necessary to the administration of the affairs of such agency.

SEC. 312. Prior to September 1, 1920, each carrier shall pay to each employee or subordinate official thereof wages or salary at a rate not less than that fixed by the decision of any agency, or railway board of adjustment in connection therewith, established for executing the powers granted the President under the Federal Control Act, in effect in respect to such employee or subordinate official immediately preceding 12.01 a. m. March 1, 1920. Any carrier acting in violation of any provision of this section shall upon conviction thereof be liable to a penalty of $100 for each such offense. Each such action with respect to any such employee or subordinate official and each day or portion thereof during which the offense continues shall constitute a separate offense. Such penalty shall be recoverable in a civil suit brought in the name of the United States, and shall be covered into the Treasury of the United States as miscellaneous receipts.

SEC. 313. The Labor Board, in case it has reason to believe that any decision of the Labor Board or of an Adjustment Board is violated by any carrier, or employee or subordinate official, or organization thereof, may upon its own motion after due notice and hearing to all persons directly interested in such violation, determine whether in its opinion such viola-

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tion has occurred and make public its decision in such manner as it may determine.

SEC. 314. The Labor Board may (1) appoint a secretary, who shall receive from the United States an annual salary of $5,000; and (2) subject to the provisions of the civil-service laws, appoint and remove such officers, employees, and agents; and make such expenditures for rent, printing, telegrams, telephone, law books, books of reference, periodicals, furniture, stationery, office equipment, and other supplies and expenses, including salaries, traveling expenses of its members, secretary, officers, employees, and agents, and witness fees, as are necessary for the efficient execution of the functions vested in the board by this title and as may be provided for by Congress from time to time. All of the expenditures of the Labor Board shall be allowed and paid upon the presentation of itemized vouchers therefor approved by the chairman of the Labor Board.

SEC. 315. There is hereby appropriated for the fiscal year ending June 30, 1920, out of any money in the Treasury not otherwise appropriated, the sum of $50,000, or so much thereof as may be necessary, to be expended by the Labor Board, for defraying the expenses of the maintenance and establishment of the board, including the payment of salaries as provided in this title.

SEC. 316. The powers and duties of the Board of Mediation and Conciliation created by the Act approved July 15, 1913, shall not extend to any dispute which may be received for hearing and decision by any Adjustment Board or the Labor Board.

Title IV.—Amendments to Interstate Commerce Act

SEC. 400. The first four paragraphs of section 1 of the Interstate Commerce Act, as such paragraphs appear in section 7 of the Commerce Court Act, are hereby amended to read as follows:

"(1) That the provisions of this Act shall apply to common carriers engaged in—

"(a) The transportation of passengers or property wholly by railroad, or partly by railroad and partly by water when

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both are used under a common control, management, or arrangement for a continuous carriage or shipment; or

"(b) The transportation of oil or other commodity, except water and except natural or artificial gas, by pipe line, or partly by pipe line and partly by railroad or by water; or

"(c) The transmission of intelligence by wire or wireless;—

from one State or Territory of the United States, or the District of Columbia, to any other State or Territory of the United States, or the District of Columbia, or from one place in a Territory to another place in the same Territory, or from any place in the United States through a foreign country to any other place in the United States, or from or to any place in the United States to or from a foreign country, but only in so far as such transportation or transmission takes place within the United States.

"(2) The provisions of this Act shall also apply to such transportation of passengers and property and transmission of intelligence, but only in so far as such transportation or transmission takes place within the United States, but shall not apply—

"(a) To the transportation of passengers or property, or to the receiving, delivering, storage, or handling of property, wholly within one State and not shipped to or from a foreign country from or to any place in the United States as aforesaid;

"(b) To the transmission of intelligence by wire or wireless wholly within one State and not transmitted to or from a foreign country from or to any place in the United States as aforesaid; or

"(c) To the transportation of passengers or property by a carrier by water where such transportation would not be subject to the provisions of this Act except for the fact that such carrier absorbs, out of its port-to-port water rates or out of its proportional through rates, any switching, terminal, lighterage, car rental, trackage, handling, or other charges by a rail carrier for services within the switching, drayage, lighterage, or corporate limits of a port terminal or district.

"(3) The term 'common carrier' as used in this Act shall include all pipe-line companies; telegraph, telephone, and cable companies operating by wire or wireless; express com-

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panies; sleeping-car companies; and all persons, natural or artificial, engaged in such transportation or transmission as aforesaid as common carriers for hire. Wherever the word 'carrier' is used in this Act it shall be held to mean 'common carrier.' The term 'railroad' as used in this Act shall include all bridges, car floats, lighters, and ferries used by or operated in connection with any railroad, and also all the road in use by any common carrier operating a railroad, whether owned or operated under a contract, agreement, or lease, and also all switches, spurs, tracks, terminals, and terminal facilities of every kind used or necessary in the transportation of the persons or property designated herein, including all freight depots, yards, and grounds, used or necessary in the transportation or delivery of any such property. The term 'transportation' as used in this Act shall include locomotives, cars, and other vehicles, vessels and all instrumentalities and facilities of shipment or carriage, irrespective of ownership or of any contract, express or implied, for the use thereof, and all services in connection with the receipt, delivery, elevation, and transfer in transit, ventilation, refrigeration or icing, storage, and handling of property transported. The term 'transmission' as used in this Act shall include the transmission of intelligence through the application of electrical energy or other use of electricity, whether by means of wire, cable, radio apparatus, or other wire or wireless conductors or appliances, and all instrumentalities and facilities for and services in connection with the receipt, forwarding, and delivery of messages, communications, or other intelligence so transmitted, hereinafter also collectively called messages.

"(4) It shall be the duty of every common carrier subject to this Act engaged in the transportation of passengers or property to provide and furnish such transportation upon reasonable request therefor, and to establish through routes and just and reasonable rates, fares, and charges applicable thereto, and to provide reasonable facilities for operating through routes and to make reasonable rules and regulations with respect to the operation of through routes, and providing for reasonable compensation to those entitled thereto; and in case of joint rates, fares, or charges, to establish just, reasonable, and equitable divisions thereof as between the

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carriers subject to this Act participating therein which shall not unduly prefer or prejudice any of such participating carriers.

"(5) All charges made for any service rendered or to be rendered in the transportation of passengers or property or in the transmission of intelligence by wire or wireless as aforesaid, or in connection therewith, shall be just and reasonable, and every unjust and unreasonable charge for such service or any part thereof is prohibited and declared to be unlawful: *Provided*, That messages by wire or wireless subject to the provisions of this Act may be classified into day, night, repeated, unrepeated, letter, commercial, press, Government, and such other classes as are just and reasonable, and different rates may be charged for the different classes of messages: *And provided further*, That nothing in this Act shall be construed to prevent telephone, telegraph, and cable companies from entering into contracts with common carriers for the exchange of services.

"(6) It is hereby made the duty of all common carriers subject to the provisions of this Act to establish, observe, and enforce just and reasonable classifications of property for transportation, with reference to which rates, tariffs, regulations, or practices are or may be made or prescribed, and just and reasonable regulations and practices affecting classifications, rates, or tariffs, the issuance, form, and substance of tickets, receipts, and bills of lading, the manner and method of presenting, marking, packing, and delivering property for transportation, the facilities for transportation, the carrying of personal, sample, and excess baggage, and all other matters relating to or connected with the receiving, handling, transporting, storing, and delivery of property subject to provisions of this Act which may be necessary or proper to secure the safe and prompt receipt, handling, transportation, and delivery of property subject to the provisions of this Act upon just and reasonable terms, and every unjust and unreasonable classification, regulation, and practice is prohibited and declared to be unlawful."

SEC. 401. The fifth, sixth, and seventh paragraphs of section 1 of the Interstate Commerce Act, as such paragraphs appear in section 7 of the Commerce Court Act, are hereby amended by inserting "(7)" at the beginning of such

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fifth paragraph, "(8)" at the beginning of such sixth paragraph, and "(9)" at the beginning of such seventh paragraph.

SEC. 402. The paragraphs added to section 1 of the Interstate Commerce Act by the Act entitled "An Act to amend an Act entitled 'An Act to regulate commerce,' as amended, in respect of car service, and for other purposes," approved May 29, 1917, are hereby amended to read as follows:

"(10) The term 'car service' in this Act shall include the use, control, supply, movement, distribution, exchange, interchange, and return of locomotives, cars, and other vehicles used in the transportation of property, including special types of equipment, and the supply of trains, by any carrier by railroad subject to this act.

"(11) It shall be the duty of every carrier by railroad subject to this Act to furnish safe and adequate car service and to establish, observe, and enforce just and reasonable rules, regulations, and practices with respect to car service; and every unjust and unreasonable rule, regulation, and practice with respect to car service is prohibited and declared to be unlawful.

"(12) It shall also be the duty of every carrier by railroad to make just and reasonable distribution of cars for transportation of coal among the coal mines served by it, whether located upon its line or lines or customarily dependent upon it for car supply. During any period when the supply of cars available for such service does not equal the requirements of such mines it shall be the duty of the carrier to maintain and apply just and reasonable ratings of such mines and to count each and every car furnished to or used by any such mine for transportation of coal against the mine. Failure or refusal so to do shall be unlawful, and in respect of each car not so counted shall be deemed a separate offense, and the carrier, receiver, or operating trustee so failing or refusing shall forfeit to the Unites States the sum of $100 for each offense, which may be recovered in a civil action brought by the United States.

"(13) The Commission is hereby authorized by general or special orders to require all carriers by railroad subject to this Act, or any of them, to file with it from time to time

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their rules and regulations with respect to car service, and the Commission may, in its discretion, direct that such rules and regulations shall be incorporated in their schedules showing rates, fares, and charges for transportation, and be subject to any or all of the provisions of this Act relating thereto.

"(14) The Commission may, after hearing, on a complaint or upon its own initiative without complaint, establish reasonable rules, regulations, and practices with respect to car service by carriers by railroad subject to this Act, including the compensation to be paid for the use of any locomotive, car, or other vehicle not owned by the carrier using it, and the penalties or other sanctions for nonobservance of such rules, regulations or practices.

"(15) Whenever the Commission is of opinion that shortage of equipment, congestion of traffic, or other emergency requiring immediate action exists in any section of the country, the Commission shall have, and it is hereby given, authority, either upon complaint or upon its own initiative without complaint, at once, if it so orders, without answer or other formal pleading by the interested carrier or carriers, and with or without notice, hearing, or the making or filing of a report, according as the Commission may determine: (a) to suspend the operation of any or all rules, regulations, or practices then established with respect to car service for such time as may be determined by the Commission; (b) to make such just and reasonable directions with respect to car service without regard to the ownership as between carriers of locomotives, cars, and other vehicles, during such emergency as in its opinion will best promote the service in the interest of the public and the commerce of the people, upon such terms of compensation as between the carriers as they may agree upon, or, in the event of their disagreement, as the Commission may after subsequent hearing find to be just and reasonable; (c) to require such joint or common use of terminals, including main-line track or tracks for a reasonable distance outside of such terminals, as in its opinion will best meet the emergency and serve the public interest, and upon such terms as between the carriers as they may agree upon, or, in the event of their disagreement, as the Commission may after subsequent hearing find to be just

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and reasonable; and (d) to give directions for preference or priority in transportation, embargoes, or movement of traffic under permits, at such time and for such periods as it may determine, and to modify, change, suspend, or annul them. In time of war or threatened war the President may certify to the Commission that it is essential to the national defense and security that certain traffic shall have preference or priority in transportation, and the Commission shall, under the power herein conferred, direct that such preference or priority be afforded.

"(16) Whenever the Commission is of opinion that any carrier by railroad subject to this Act is for any reason unable to transport the traffic offered it so as properly to serve the public, it may, upon the same procedure as provided in paragraph (15), make such just and reasonable directions with respect to the handling, routing, and movement of the traffic of such carrier and its distribution over other lines of roads, as in the opinion of the Commission will best promote the service in the interest of the public and the commerce of the people, and upon such terms as between the carriers as they may agree upon, or, in the event of their disagreement, as the Commission may after subsequent hearing find to be just and reasonable.

"(17) The directions of the Commission as to car service and to the matters referred to in paragraphs (15) and (16) may be made through and by such agents or agencies as the Commission shall designate and appoint for that purpose. It shall be the duty of all carriers by railroad subject to this Act, and of their officers, agents, and employees, to obey strictly and conform promptly to such orders or directions of the Commission, and in case of failure or refusal on the part of any carrier, receiver, or operating trustee to comply with any such order or direction such carrier, receiver, or trustee shall be liable to a penalty of not less than $100 nor more than $500 for each such offense and $50 for each and every day of the continuance of such offense, which shall accrue to the United States and may be recovered in a civil action brought by the United States: *Provided, however*, That nothing in this Act shall impair or affect the right of a State, in the exercise of its police power, to require just and reasonable freight and passenger service

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for intrastate business, except in so far as such requirement is inconsistent with any lawful order of the Commission made under the provisions of this Act.

"(18) After ninety days after this paragraph takes effect no carrier by railroad subject to this Act shall undertake the extension of its line of railroad, or the construction of a new line of railroad, or shall acquire or operate any line of railroad, or extension thereof, or shall engage in transportation under this Act over or by means of such additional or extended line of railroad, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction, or operation, or construction and operation, of such additional or extended line of railroad, and no carrier by railroad subject to this Act shall abandon all or any portion of a line of railroad, or the operation thereof, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity permit of such abandonment.

"(19) The application for and issuance of any such certificate shall be under such rules and regulations as to hearings and other matters as the Commission may from time to time prescribe, and the provisions of this Act shall apply to all such proceedings. Upon receipt of any application for such certificate the Commission shall cause notice thereof to be given to and a copy filed with the governor of each State in which such additional or extended line of railroad is proposed to be constructed or operated, or all or any portion of a line of railroad, or the operation thereof, is proposed to be abandoned, with the right to be heard as hereinafter provided with respect to the hearing of complaints or the issuance of securities; and said notice shall also be published for three consecutive weeks in some newspaper of general circulation in each county in or through which said line of railroad is constructed or operates.

"(20) The Commission shall have power to issue such certificate as prayed for, or to refuse to issue it, or to issue it for a portion or portions of a line of railroad, or extension thereof, described in the application, or for the partial exercise only of such right or privilege, and may attach to the

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issuance of the certificate such terms and conditions as in its judgment the public convenience and necessity may require. From and after issuance of such certificate, and not before, the carrier by railroad may, without securing approval other than such certificate, comply with the terms and conditions contained in or attached to the issuance of such certificate and proceed with the construction, operation, or abandonment covered thereby. Any construction, operation, or abandonment contrary to the provisions of this paragraph or of paragraph (18) or (19) of this section may be enjoined by any court of competent jurisdiction at the suit of the United States, the Commission, any commission or regulating body of the State or States affected, or any party in interest; and any carrier which, or any director, officer, receiver, operating trustee, lessee, agent, or person, acting for or employed by such carrier, who knowingly authorizes, consents to, or permits any violation of the provisions of this paragraph or of paragraph (18) of this section, shall upon conviction thereof be punished by a fine of not more than $5,000 or by imprisonment for not more than three years, or both.

"(21) The Commission may, after hearing, in a proceeding upon complaint or upon its own initiative without complaint, authorize or require by order any carrier by railroad subject to this Act, party to such proceeding, to provide itself with safe and adequate facilities for performing as a common carrier its car service as that term is used in this Act, and to extend its line or lines: *Provided*, That no such authorization or order shall be made unless the Commission finds, as to such extension, that it is reasonably required in the interest of public convenience and necessity, or as to such extension or facilities that the expense involved therein will not impair the ability of the carrier to perform its duty to the public. Any carrier subject to this Act which refuses or neglects to comply with any order of the Commission made in pursuance of this paragraph shall be liable to a penalty of $100 for each day during which such refusal or neglect continues, which shall accrue to the United States and may be recovered in a civil action brought by the United States.

"(22) The authority of the Commission conferred by paragraphs (18) to (21), both inclusive, shall not extend

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to the construction or abandonment of spur, industrial, team, switching or side tracks, located or to be located wholly within one State, or of street, suburban, or interurban electric railways, which are not operated as a part or parts of a general steam railroad system of transportation."

SEC. 403. The fifteenth and sixteenth paragraphs of section 1 of the Interstate Commerce Act, added to such section by the Act entitled "An Act to amend the Act to regulate commerce, as amended, and for other purposes," approved August 10, 1917, are hereby amended by inserting "(23)" at the beginning of such fifteenth paragraph and "(24)" at the beginning of such sixteenth paragraph.

SEC. 404. Section 2 of the Interstate Commerce Act is hereby amended to read as follows:

"SEC. 2. That if any common carrier subject to the provisions of this Act shall, directly or indirectly, by any special rate, rebate, drawback, or other device, charge, demand, collect, or receive from any person or persons a greater or less compensation for any service rendered, or to be rendered, in the transportation of passengers or property or the transmission of intelligence, subject to the provisions of this Act, than it charges, demands, collects, or receives from any other person or persons for doing for him or them a like and contemporaneous service in the transportation or transmission of a like kind of traffic or message under substantially similar circumstances and conditions, such common carrier shall be deemed guilty of unjust discrimination, which is hereby prohibited and declared to be unlawful."

SEC. 405. The first paragraph of section 3 of the Interstate Commerce Act is hereby amended by inserting "(1)" after the section number at the beginning thereof.

Section 3 of the Interstate Commerce Act is hereby amended by adding after the first paragraph a new paragraph to read as follows:

"(2) From and after July 1, 1920, no carrier by railroad subject to the provisions of this Act shall deliver or relinquish possession at destination of any freight transported by it until all tariff rates and charges thereon have been paid, except under such rules and regulations as the Commission may from time to time prescribe to assure prompt payment of all such rates and charges and to prevent unjust discrim-

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ination: *Provided*, That the provisions of this paragraph shall not be construed to prohibit any carrier from extending credit in connection with rates and charges on freight transported for the United States, for any department, bureau, or agency thereof, or for any State or Territory or political subdivision thereof, or for the District of Columbia."

The second paragraph of section 3 of the Interstate Commerce Act is hereby amended to read as follows:

"(3) All carriers, engaged in the transportation of passengers or property, subject to the provisions of this Act, shall, according to their respective powers, afford all reasonable, proper, and equal facilities for the interchange of traffic between their respective lines, and for the receiving, forwarding, and delivering of passengers or property to and from their several lines and those connecting therewith, and shall not discriminate in their rates, fares, and charges between such connecting lines, or unduly prejudice any such connecting line in the distribution of traffic that is not specifically routed by the shipper.

"(4) If the Commission finds it to be in the public interest and to be practicable, without substantially impairing the ability of a carrier owning or entitled to the enjoyment of terminal facilities to handle its own business, it shall have power to require the use of any such terminal facilities, including main-line track or tracks for a reasonable distance outside of such terminal, of any carrier, by another carrier or other carriers, on such terms and for such compensation as the carriers affected may agree upon, or, in the event of a failure to agree, as the Commission may fix as just and reasonable for the use so required, to be ascertained on the principle controlling compensation in condemnation proceedings. Such compensation shall be paid or adequately secured before the enjoyment of the use may be commenced. If under this paragraph the use of such terminal facilities of any carrier is required to be given to another carrier or other carriers, and the carrier whose terminal facilities are required to be so used is not satisfied with the terms fixed for such use, or if the amount of compensation so fixed is not duly and promptly paid, the carrier whose terminal facilities have thus been required to be given to another carrier or other carriers shall be entitled to recover, by suit or action against

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such other carrier or carriers, proper damages for any injuries sustained by it as the result of compliance with such requirement, or just compensation for such use, or both, as the case may be."

SEC. 406. Section 4 of the Interstate Commerce Act is hereby amended to read as follows:

"SEC. 4. (1) That it shall be unlawful for any common carrier subject to the provisions of this Act to charge or receive any greater compensation in the aggregate for the transportation of passengers, or of like kind of property, for a shorter than for a longer distance over the same line or route in the same direction, the shorter being included within the longer distance, or to charge any greater compensation as a through rate than the aggregate of the intermediate rates subject to the provisions of this Act, but this shall not be construed as authorizing any common carrier within the terms of this Act to charge or receive as great compensation for a shorter as for a longer distance: *Provided*, That upon application to the Commission such common carrier may in special cases, after investigation, be authorized by the Commission to charge less for longer than for shorter distances for the transportation of passengers or property; and the Commission may from time to time prescribe the extent to which such designated common carrier may be relieved from the operation of this section; but in exercising the authority conferred upon it in this proviso the Commission shall not permit the establishment of any charge to or from the more distant point that is not reasonably compensatory for the service performed; and if a circuitous rail line or route is, because of such circuity, granted authority to meet the charges of a more direct line or route to or from competitive points and to maintian higher charges to or from intermediate points on its line, the authority shall not include intermediate points as to which the haul of the petitioning line or route is not longer than that of the direct line or route between the competitive points; and no such authorization shall be granted on account of merely potential water competition not actually in existence: *And provided further*, That rates, fares, or charges existing at the time of the passage of this amendatory Act by virtue of orders of the Commission or as to which application has theretofore been filed

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with the Commission and not yet acted upon, shall not be required to be changed by reason of the provisions of this section until the further order of or a determination by the Commission.

"(2) Wherever a carrier by railroad shall in competition with a water route or routes reduce the rates on the carriage of any species of freight to or from competitive points it shall not be permitted to increase such rates unless after hearing by the Commission it shall be found that such proposed increase rests upon changed conditions other than the elimination of water competition."

SEC. 407. The first paragraph of section 5 of the Inter state Commerce Act is hereby amended to read as follows:

"SEC. 5. (1) That, except upon specific approval by order of the Commission as in this section provided, and except as provided in paragraph (16) of section 1 of this Act, it shall be unlawful for any common carrier subject to this Act to enter into any contract, agreement, or combination with any other common carrier or carriers for the pooling of freights of different and competing railroads, or to divide between them the aggregate or net proceeds of the earnings of such railroads, or any portion thereof; and in any case of an agreement for the pooling of freights as aforesaid each day of its continuance shall be deemed a separate offense: *Provided*, That whenever the Commission is of opinion, after hearing upon application of any carrier or carriers engaged in the transportation of passengers or property subject to this Act, or upon its own initiative, that the division of their traffic or earnings, to the extent indicated by the Commission, will be in the interest of better service to the public, or economy in operation, and will not unduly restrain competition, the Commission shall have authority by order to approve and authorize, if assented to by all the carriers involved, such division of traffic or earnings, under such rules and regulations, and for such consideration as between such carriers and upon such terms and conditions, as shall be found by the Commission to be just and reasonable in the premises.

"(2) Whenever the Commission is of opinion, after hearing, upon application of any carrier or carriers engaged in the transportation of passengers or property subject to this

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Act, that the acquisition, to the extent indicated by the Commission, by one of such carriers of the control of any other such carrier or carriers either under a lease or by the purchase of stock or in any other manner not involving the consolidation of such carriers into a single system for ownership and operation, will be in the public interest, the Commission shall have authority by order to approve and authorize such acquisition, under such rules and regulations and for such consideration and on such terms and conditions as shall be found by the Commission to be just and reasonable in the premises.

"(3) The Commission may from time to time, for good cause shown, make such orders, supplemental to any order made under paragraph (1) or (2), as it may deem necessary or appropriate.

"(4) The Commission shall as soon as practicable prepare and adopt a plan for the consolidation of the railway properties of the continental United States into a limited number of systems. In the division of such railways into such systems under such plan, competition shall be preserved as fully as possible and wherever practicable the existing routes and channels of trade and commerce shall be maintained. Subject to the foregoing requirements, the several systems shall be so arranged that the cost of transportation as between competitive systems and as related to the values of the properties through which the service is rendered shall be the same, so far as practicable, so that these systems can employ uniform rates in the movement of competitive traffic and under efficient management earn substantially the same rate of return upon the value of their respective railway properties.

"(5) When the Commission has agreed upon a tentative plan, it shall give the same due publicity and upon reasonable notice, including notice to the Governor of each State, shall hear all persons who may file or present objections thereto. The Commission is authorized to prescribe a procedure for such hearings and to fix a time for bringing them to a close. After the hearings are at an end, the Commission shall adopt a plan for such consolidation and publish the same; but it may at any time thereafter, upon its own motion or upon application, reopen the subject for such

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changes or modifications as in its judgment will promote the public interest. The consolidations herein provided for shall be in harmony with such plan.

"(6) It shall be lawful for two or more carriers by railroad, subject to this Act, to consolidate their properties or any part thereof, into one corporation for the ownership, management, and operation of the properties theretofore in separate ownership, management, and operation, under the following conditions:

"(a) The proposed consolidation must be in harmony with and in furtherance of the complete plan of consolidation mentioned in paragraph (5) and must be approved by the Commission;

"(b) The bonds at par of the corporation which is to become the owner of the consolidated properties, together with the outstanding capital stock at par of such corporation, shall not exceed the value of the consolidated properties as determined by the Commission. The value of the properties sought to be consolidated shall be ascertained by the Commission under section 19a of this Act, and it shall be the duty of the Commission to proceed immediately to the ascertainment of such value for the properties involved in a proposed consolidation upon the filing of the application for such consolidation.

"(c) Whenever two or more carriers propose a consolidation under this section, they shall present their application therefore to the Commission, and thereupon the Commission shall notify the Governor of each State in which any part of the properties sought to be consolidated is situated and the carriers involved in the proposed consolidation, of the time and place for a public hearing. If after such hearing the Commission finds that the public interest will be promoted by the consolidation and that the conditions of this section have been or will be fulfilled, it may enter an order approving and authorizing such consolidation, with such modifications and upon such terms and conditions as it my prescribe, and thereupon such consolidation may be effected, in accordance with such order, if all the carriers involved assent thereto, the law of any State or the decision or order of any State authority to the contrary notwithstanding

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"(7) The power and authority of the Commission to approve and authorize the consolidation of two or more carriers shall extend and apply to the consolidation of four express companies into the American Railway Express Company, a Delaware corporation, if application for such approval and authority is made to the Commission within thirty days after the passage of this amendatory Act; and pending the decision of the Commission such consolidation shall not be dissolved.

"(8) The carriers affected by any order made under the foregoing provisions of this section and any corporation organized to effect a consolidation approved and authorized in such order shall be, and they are hereby, relieved from the operation of the 'antitrust laws,' as designated in section 1 of the Act entitled 'An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes,' approved October 15, 1914, and of all other restraints or prohibitions by law, State or Federal, in so far as may be necessary to enable them to do anything authorized or required by any order made under and pursuant to the foregoing provisions of this section."

SEC. 408. The paragraph of section 5 of the Interstate Commerce Act, added to such section by section 11 of the Act entitled "An Act to provide for the opening, maintenance, protection, and operation of the Panama Canal and the sanitation and government of the Canal Zone," approved August 24, 1912, is hereby amended by inserting "(9)" at the beginning thereof.

The two paragraphs of section 11 of such Act of August 24, 1912, which follow the paragraph added by such section to section 5 of the Interstate Commerce Act, are hereby made a part of section 5 of the Interstate Commerce Act. The first paragraph so made a part of section 5 of the Interstate Commerce Act is hereby amended by inserting "(10)" at the beginning thereof, and the second such paragraph is hereby amended by inserting "(11)" at the beginning thereof.

SEC. 409. Section 6 of the Interstate Commerce Act is hereby amended by inserting "(1)" after the section number at the beginning of the first paragraph, "(2)" at the beginning of the second paragraph, "(3)" at the beginning

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"(3) Whenever in any investigation under the provisions of this Act, or in any investigation instituted upon petition of the carrier concerned, which petition is hereby authorized to be filed, there shall be brought in issue any rate, fare, charge, classification, regulation, or practice, made or imposed by authority of any State, or initiated by the President during the period of Federal control, the Commission, before proceeding to hear and dispose of such issue, shall cause the State or States interested to be notified of the proceeding. The Commission may confer with the authorities of any State having regulatory jurisdiction over the class of persons and corporations subject to this Act with respect to the relationship between rate structures and practices of carriers subject to the jurisdiction of such State bodies and of the Commission; and to that end is authorized and empowered, under rules to be prescribed by it, and which may be modified from time to time, to hold joint hearings with any such State regulating bodies on any matters wherein the Commission is empowered to act and where the rate-making authority of a State is or may be affected by the action taken by the Commission. The Commission is also authorized to avail itself of the cooperation, services, records, and facilities of such State authorities in the enforcement of any provision of this Act.

"(4) Whenever in any such investigation the Commission, after full hearing, finds that any such rate, fare, charge, classification, regulation, or practice causes any undue or unreasonable advantage, preference, or prejudice as between persons or localities in intrastate commerce on the one hand and interstate or foreign commerce on the other hand, or any undue, unreasonable, or unjust discrimination against interstate or foreign commerce, which is hereby forbidden and declared to be unlawful, it shall prescribe the rate, fare, or charge, or the maximum or minimum, or maximum and minimum, thereafter to be charged, and the classification, regulation, or practice thereafter to be observed, in such manner as, in its judgment, will remove such advantage, preference, prejudice, or discrimination. Such rates, fares, charges, classifications, regulations, and practices shall be observed while in effect by the carriers parties to such proceeding affected thereby, the law of any State or the de-

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cision or order of any State authority to the contrary notwithstanding."

SEC. 417. Section 14 of the Interstate Commerce Act is hereby amended by inserting "(1)" after the section number at the beginning of the first paragraph, "(2)" at the beginning of the second paragraph, and "(3)" at the beginning of the third paragraph.

SEC. 418. The first four paragraphs of section 15 of the Interstate Commerce Act are hereby amended to read as follows:

"SEC. 15. (1) That whenever, after full hearing, upon a complaint made as provided in section 13 of this Act, or after full hearing under an order for investigation and hearing made by the Commission on its own initiative, either in extension of any pending complaint or without any complaint whatever, the Commission shall be of opinion that any individual or joint rate, fare, or charge whatsoever demanded, charged, or collected by any common carrier or carriers subject to this Act for the transportation of persons or property or for the transmission of messages as defined in the first section of this Act, or that any individual or joint classification, regulation, or practice whatsoever of such carrier or carriers subject to the provisions of this Act, is or will be unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial, or otherwise in violation of any of the provisions of this Act, the Commission is hereby authorized and empowered to determine and prescribe what will be the just and reasonable individual or joint rate, fare, or charge, or rates, fares, or charges, to be thereafter observed in such case, or the maximum or minimum, or maximum and minimum, to be charged (or, in the case of a through route where one of the carriers is a water line, the maximum rates, fares, and charges applicable thereto), and what individual or joint classification, regulation, or practice is or will be just, fair, and reasonable, to be thereafter followed, and to make an order that the carrier or carriers shall cease and desist from such violation to the extent to which the Commission finds that the same does or will exist, and shall not thereafter publish, demand, or collect any rate, fare, or charge for such transportation or transmission other than the rate, fare, or

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charge so prescribed, or in excess of the maximum or less than the minimum so prescribed, as the case may be, and shall adopt the classification and shall conform to and observe the regulation or practice so prescribed.

"(2) Except as otherwise provided in this Act, all orders of the Commission, other than orders for the payment of money, shall take effect within such reasonable time, not less than thirty days, and shall continue in force until its further order, or for a specified period of time, according as shall be prescribed in the order, unless the same shall be suspended or modified or set aside by the Commission, or be suspended or set aside by a court of competent jurisdiction.

"(3) The Commission may, and it shall whenever deemed by it to be necessary or desirable in the public interest, after full hearing upon complaint or upon its own initiative without a complaint, establish through routes, joint classifications, and joint rates, fares, or charges, applicable to the transportation of passengers or property, or the maxima or minima, or maxima and minima, to be charged (or, in the case of a through route where one of the carriers is a water line, the maximum rates, fares, and charges applicable thereto), and the divisions of such rates, fares, or charges as hereinafter provided, and the terms and conditions under which such through routes shall be operated; and this provision, except as herein otherwise provided, shall apply when one of the carriers is a water line. The Commission shall not, however, establish any through route, classification, or practice, or any rate, fare, or charge, between street electric passenger railways not engaged in the general business of transporting freight in addition to their passenger and express business, and railroads of a different character; nor shall the Commission have the right to establish any route, classification, or practice, or any rate, fare, or charge when the transportation is wholly by water, and any transportation by water affected by this Act shall be subject to the laws and regulations applicable to transportation by water.

"(4) In establishing any such through route the Commission shall not (except as provided in section 3, and except where one of the carriers is a water line), require any carrier by railroad, without its consent, to embrace in such route

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substantially less than the entire length of its railroad and of any intermediate railroad operated in conjunction and under a common management or control therewith, which lies between the termini of such proposed through route, unless such inclusion of lines would make the through route unreasonably long as compared with another practicable through route which could otherwise be established: *Provided*, That in time of shortage of equipment, congestion of traffic, or other emergency declared by the Commission it may (either upon complaint or upon its own initiative without complaint, at once, if it so orders without answer or other formal pleadings by the interested carrier or carriers, and with or without notice, hearing, or the making or filing of a report, according as the Commission may determine) establish temporarily such through routes as in its opinion are necessary or desirable in the public interest.

"(5) Transportation wholly by railroad of ordinary livestock in car-load lots destined to or received at public stockyards shall include all necessary service of unloading and reloading en route, delivery at public stockyards of inbound shipments into suitable pens, and receipt and loading at such yards of outbound shipments, without extra charge therefor to the shipper, consignee or owner, except in cases where the unloading or reloading en route is at the request of the shipper, consignee or owner, or to try an intermediate market, or to comply with quarantine regulations. The Commission may prescribe or approve just and reasonable rules governing each of such excepted services. Nothing in this paragraph shall be construed to affect the duties and liabilities of the carriers now existing by virtue of law respecting the transportation of other than ordinary livestock, or the duty of performing service as to shipments other than those to or from public stockyards.

"(6) Whenever, after full hearing upon complaint or upon its own initiative, the Commission is of opinion that the divisions of joint rates, fares, or charges, applicable to the transportation of passengers or property, are or will be unjust, unreasonable, inequitable, or unduly preferential or prejudicial as between the carriers parties thereto (whether agreed upon by such carriers, or any of them, or otherwise established),

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the Commission shall by order prescribe the just, reasonable, and equitable divisions thereof to be received by the several carriers, and in cases where the joint rate, fare, or charge was established pursuant to a finding or order of the Commission and the divisions thereof are found by it to have been unjust, unreasonable, or inequitable, or unduly preferential or prejudicial, the Commission may also by order determine what (for the period subsequent to the filing of the complaint or petition or the making of the order of investigation) would have been the just, reasonable, and equitable divisions thereof to be received by the several carriers, and require adjustment to be made in accordance therewith. In so prescribing and determining the divisions of joint rates, fares and charges, the Commission shall give due consideration, among other things, to the efficiency with which the carriers concerned are operated, the amount of revenue required to pay their respective operating expenses, taxes, and a fair return on their railway property held for and used in the service of transportation, and the importance to the public of the transportation services of such carriers; and also whether any particular participating carrier is an originating, intermediate, or delivering line, and any other fact or circumstance which would ordinarily, without regard to the mileage haul, entitle one carrier to a greater or less proportion than another carrier of the joint rate, fare or charge.

"(7) Whenever there shall be filed with the Commission any schedule stating a new individual or joint rate, fare, or charge, or any new individual or joint classification, or any new individual or joint regulation or practice affecting any rate, fare, or charge, the Commission shall have, and it is hereby given, authority, either upon complaint or upon its own initiative without complaint, at once, and if it so orders without answer or other formal pleading by the interested carrier or carriers, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, fare, charge, classification, regulation, or practice; and pending such hearing and the decision thereon the Commission, upon filing with such schedule and delivering to the carrier or carriers affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, fare, charge, classification, regula-

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tion, or practice, but not for a longer period than one hundred and twenty days beyond the time when it would otherwise go into effect; and after full hearing, whether completed before or after the rate, fare, charge, classification, regulation, or practice goes into effect, the Commission may make such order with reference thereto as would be proper in a proceeding initiated after it had become effective. If any such hearing can not be concluded within the period of suspension, as above stated, the Commission may extend the time of suspension for a further period not exceeding thirty days, and if the proceeding has not been concluded and an order made at the expiration of such thirty days, the proposed change of rate, fare, charge, classification, regulation, or practice shall go into effect at the end of such period, but, in case of a proposed increased rate or charge for or in respect to the transportation of property, the Commission may by order require the interested carrier or carriers to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require the interested carrier or carriers to refund, with interest, to the persons in whose behalf such amounts were paid such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate, fare, or charge increased after January 1, 1910, or of a rate, fare, or charge sought to be increased after the passage of this Act, the burden of proof to show that the increased rate, fare, or charge, or proposed increased rate, fare, or charge, is just and reasonable shall be upon the carrier, and the Commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible."

SEC. 419. The fifth paragraph of section 15 of the Interstate Commerce Act is hereby amended by inserting "(8)" at the beginning of such paragraph.

SEC. 420. Section 15 of the Interstate Commerce Act is hereby amended by inserting after the fifth paragraph two new paragraphs, to read as follows:

"(9) Whenever property is diverted or delivered by one carrier to another carrier contrary to routing instructions in

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the bill of lading, unless such diversion or delivery is in compliance with a lawful order, rule, or regulation of the Commission, such carriers shall, in a suit or action in any court of competent jurisdiction, be jointly and severally liable to the carrier thus deprived of its right to participate in the haul of the property, for the total amount of the rate or charge it would have received had it participated in the haul of the property. The carrier to which the property is thus diverted shall not be liable in such suit or action if it can show, the burden of proof being upon it, that before carrying the property it had no notice, by bill of lading, waybill or otherwise, of the routing instructions. In any judgment which may be rendered the plaintiff shall be allowed to recover against the defendant a reasonable attorneys' fee to be taxed in the case.

"(10) With respect to traffic not routed by the shipper, the Commission may, whenever the public interest and a fair distribution of the traffic require, direct the route which such traffic shall take after it arrives at the terminus of one carrier or at a junction point with another carrier, and is to be there delivered to another carrier."

SEC. 421. Section 15 of the Interstate Commerce Act is hereby further amended by inserting "(11)" at the beginning of the sixth paragraph, "(12)" at the beginning of the seventh paragraph, "(13)" at the beginning of the eighth paragraph, and "(14)" at the beginning of the ninth paragraph.

SEC. 422. The Interstate Commerce Act is further amended by inserting after section 15 a new section to be known as section 15a and to read as follows:

"SEC. 15a. (1) When used in this section the term 'rates' means rates, fares, and charges, and all classifications, regulations, and practices, relating thereto; the term 'carrier' means a carrier by railroad or partly by railroad and partly by water, within the continental United States, subject to this Act, excluding (a) sleeping-car companies and express companies, (b) street or suburban electric railways unless operated as a part of a general steam railroad system of transportation, (c) interurban electric railways unless operated as a part of a general steam railroad system of transportation

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or engaged in the general transportation of freight, and (d) any belt-line railroad, terminal switching railroad, or other terminal facility, owned exclusively and maintained, operated, and controlled by any State or political subdivision thereof; and the term 'net railway operating income' means railway operating income, including in the computation thereof debits and credits arising from equipment rents and joint facility rents.

"(2) In the exercise of its power to prescribe just and reasonable rates the Commission shall initiate, modify, establish or adjust such rates so that carriers as a whole (or as a whole in each of such rate groups or territories as the Commission may from time to time designate) will, under honest, efficient and economical management and reasonable expenditures for maintenance of way, structures and equipment, earn an aggregate annual net railway operating income equal, as nearly as may be, to a fair return upon the aggregate value of the railway property of such carriers held for and used in the service of transportation: *Provided*, That the Commission shall have reasonable latitude to modify or adjust any particular rate which it may find to be unjust or unreasonable, and to prescribe different rates for different sections of the country.

"(3) The Commission shall from time to time determine and make public what percentage of such aggregate property value constitutes a fair return thereon, and such percentage shall be uniform for all rate groups or territories which may be designated by the Commission. In making such determination it shall give due consideration, among other things, to the transportation needs of the country and the necessity (under honest, efficient and economical management of existing transportation facilities) of enlarging such facilities in order to provide the people of the United States with adequate transportation: *Provided*, That during the two years beginning March 1, 1920, the Commission shall take as such fair return a sum equal to 5½ per centum of such aggregate value, but may, in its discretion, add thereto a sum not exceeding one-half of one per centum of such aggregate value to make provision in whole or in part for improvements, betterments or equipment, which, according to the accounting system prescribed by the Commission, are chargeable to capital account.

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"(4) For the purposes of this section, such aggregate value of the property of the carriers shall be determined by the Commission from time to time and as often as may be necessary. The Commission may utilize the results of its investigation under section 19a of this Act, in so far as deemed by it available, and shall give due consideration to all the elements of value recognized by the law of the land for rate-making purposes, and shall give to the property investment account of the carriers only that consideration which under such law it is entitled to in establishing values for rate-making purposes. Whenever pursuant to section 19a of this Act the value of the railway property of any carrier held for and used in the service of transportation has been finally ascertained, the value so ascertained shall be deemed by the Commission to be the value thereof for the purpose of determining such aggregate value.

"(5) Inasmuch as it is impossible (without regulation and control in the interest of the commerce of the United States considered as a whole) to establish uniform rates upon competitive traffic which will adequately sustain all the carriers which are engaged in such traffic and which are indispensable to the communities to which they render the service of transportation, without enabling some of such carriers to receive a net railway operating income substantially and unreasonably in excess of a fair return upon the value of their railway property held for and used in the service of transportation, it is hereby declared that any carrier which receives such an income so in excess of a fair return, shall hold such part of the excess, as hereinafter prescribed, as trustee for, and shall pay it to, the United States.

"(6) If, under the provisions of this section, any carrier receives for any year a net railway operating income in excess of 6 per centum of the value of the railway property held for and used by it in the service of transportation, one-half of such excess shall be placed in a reserve fund established and maintained by such carrier, and the remaining one-half thereof shall, within the first four months following the close of the period for which such computation is made, be recoverable by and paid to the Commission for the purpose of establishing and maintaining a general railroad contingent fund as hereinafter described. For the purposes of this paragraph the value

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of the railway property and the net railway operating income of a group of carriers, which the Commission finds are under common control and management and are operated as a single system, shall be computed for the system as a whole irrespective of the separate ownership and accounting returns of the various parts of such system. In the case of any carrier which has accepted the provisions of section 209 of this amendatory Act the provisions of this paragraph shall not be applicable to the income for any period prior to September 1, 1920. The value of such railway property shall be determined by the Commission in the manner provided in paragraph (4).

"(7) For the purpose of paying dividends or interest on its stocks, bonds or other securities, or rent for leased roads, a carrier may draw from the reserve fund established and maintained by it under the provisions of this section to the extent that its net railway operating income for any year is less than a sum equal to 6 per centum of the value of the railway property held for and used by it in the service of transportation, determined as provided in paragraph (6); but such fund shall not be drawn upon for any other purpose.

"(8) Such reserve fund need not be accumulated and maintained by any carrier beyond a sum equal to 5 per centum of the value of its railway property determined as herein provided, and when such fund is so accumulated and maintained the portion of its excess income which the carrier is permitted to retain under paragraph (6) may be used by it for any lawful purpose.

"(9) The Commission shall prescribe rules and regulations for the determination and recovery of the excess income payable to it under this section, and may require such security and prescribe such reasonable terms and conditions in connection therewith as it may find necessary. The Commission shall make proper adjustments to provide for the computation of excess income for a portion of a year, and for a year in which a change in the percentage constituting a fair return or in the value of a carrier's railway property becomes effective.

"(10) The general railroad contingent fund so to be recoverable by and paid to the Commission and all accretions thereof shall be a revolving fund and shall be administered

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by the Commission. It shall be used by the Commission in furtherance of the public interest in railway transportation either by making loans to carriers to meet expenditures for capital account or to refund maturing securities originally issued for capital account, or by purchasing transportation equipment and facilities and leasing the same to carriers, as hereinafter provided. Any moneys in the fund not so employed shall be invested in obligations of the United States or deposited in authorized depositaries of the United States subject to the rules promulgated from time to time by the Secretary of the Treasury relating to Government deposits.

"(11) A carrier may at any time make application to the Commission for a loan from the general railroad contingent fund, setting forth the amount of the loan and the term for which it is desired, the purpose of the loan and the uses to which it will be applied, the present and prospective ability of the applicant to repay the loan and meet the requirements of its obligations in that regard, the character and value of the security offered, and the extent to which the public convenience and necessity will be served. The application shall be accompanied by statements showing such facts and details as the Commission may require with respect to the physical situation, ownership, capitalization, indebtedness, contract obligations, operation, and earning power of the applicant, together with such other facts relating to the propriety and expediency of granting the loan applied for and the ability of the applicant to make good the obligation, as the Commission may deem pertinent to the inquiry.

"(12) If the Commission, after such hearing and investigation, with or without notice, as it may direct, finds that the making, in whole or in part, of the proposed loan from the general railroad contingent fund is necessary to enable the applicant properly to meet the transportation needs of the public, and that the prospective earning power of the applicant and the character and value of the security offered are such as to furnish reasonable assurance of the applicant's ability to repay the loan within the time fixed therefor, and to meet its other obligations in connection with such loan, the Commission may make a loan to the applicant from such railroad contingent fund, in such amount, for such length of time, and under such terms and conditions as it may deem

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proper. The Commission shall also prescribe the security to be furnished, which shall be adequate to secure the loan. All such loans shall bear interest at the rate of 6 per centum per annum, payable semiannually to the Commission. Such loans when repaid, and all interest paid thereon, shall be placed in the general railroad contingent fund.

"(13) A carrier may at any time make application to the Commission for the lease to it of transportation equipment or facilities, purchased from the general railroad contingent fund, setting forth the kind and amount of such equipment or facilities and the term for which it is desired to be leased, the uses to which it is proposed to put such equipment or facilities, the present and prospective ability of the applicant to pay the rental charges thereon and to meet the requirements of its obligations under the lease, and the extent to which the public convenience and necessity will be served. The application shall be accompanied by statements showing such facts and details as the Commission may require with respect to the physical situation, ownership, capitalization, indebtedness, contract obligations, operation, and earning power of the applicant, together with such other facts relating to the propriety and expediency of leasing such equipment or facilities to the applicant as the Commission may deem pertinent to the inquiry.

"(14) If the Commission, after such hearing and investigation, with or without notice, as it may direct, finds that the leasing to the applicant of such equipment or facilities, in whole or in part, is necessary to enable the applicant properly to meet the transportation needs of the public, and that the prospective earning power of the applicant is such as to furnish reasonable assurance of the applicant's ability to pay promptly the rental charges and meet its other obligations under such lease, the Commission may lease such equipment or facilities purchased by it from the general railroad contingent fund, to the applicant for such length of time, and under such terms and conditions as it may deem proper. The rental charges provided in every such lease shall be at least sufficient to pay a return of 6 per centum per annum, plus allowance for depreciation determined as provided in paragraph (5) of section 20 of this Act, upon the value of the equipment or facilities leased thereunder. All rental charges and

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other payments received by the Commission in connection with such equipment and facilities, including amounts received under any sale thereof, shall be placed in the general railroad contingent fund.

"(15) The Commission may from time to time purchase, contract for the construction, repair and replacement of, and sell, equipment and facilities, and enter into and carry out contracts and other obligations in connection therewith, to the extent that moneys included in the general railroad contingent fund are available therefor, and in so far as necessary to enable it to secure and supply equipment and facilities to carriers whose applications therefor are approved under the provisions of this section, and to maintain and dispose of such equipment and facilities.

"(16) The Commission may from time to time prescribe such rules and regulations as it deems necessary to carry out the provisions of this section respecting the making of loans and the lease of equipment and facilities.

"(17) The provisions of this section shall not be construed as depriving shippers of their right to reparation in case of overcharges, unlawfully excessive or discriminatory rates, or rates excessive in their relation to other rates, but no shipper shall be entitled to recover upon the sole ground that any particular rate may reflect a proportion of excess income to be paid by the carrier to the Commission in the public interest under the provisions of this section.

"(18) Any carrier, or any corporation organized to construct and operate a railroad, proposing to undertake the construction and operation of a new line of railroad may apply to the Commission for permission to retain for a period not to exceed ten years all or any part of its earnings derived from such new construction in excess of the amount heretofore in this section provided, for such disposition as it may lawfully make of the same, and the Commission may, in its discretion, grant such permission, conditioned, however, upon the completion of the work of construction within a period to be designated by the Commission in its order granting such permission."

SEC. 423. The first paragraph of section 16 of the Interstate Commerce Act is hereby amended by inserting "(1)" after the section number at the beginning of such paragraph.

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SEC. 424. The second paragraph of section 16 of the Interstate Commerce Act is hereby amended by inserting "(2)" at the beginning of such paragraph, and by striking out the last sentence thereof and inserting in lieu thereof the following as a new paragraph:

"(3) All actions at law by carriers subject to this Act for recovery of their charges, or any part thereof, shall be begun within three years from the time the cause of action accrues, and not after. All complaints for the recovery of damages shall be filed with the Commission within two years from the time the cause of action accrues, and not after, unless the carrier, after the expiration of such two years or within ninety days before such expiration, begins an action for recovery of charges in respect of the same service, in which case such period of two years shall be extended to and including ninety days from the time such action by the carrier is begun. In either case the cause of action in respect of a shipment of property shall, for the purposes of this section, be deemed to accrue upon delivery or tender of delivery thereof by the carrier, and not after. A petition for the enforcement of an order for the payment of money shall be filed in the district court or State court within one year from the date of the order, and not after."

SEC. 425. The third, fourth, fifth, and sixth paragraphs of section 16 of the Interstate Commerce Act are hereby amended by inserting "(4)" at the beginning of the third paragraph, "(5)" at the beginning of the fourth paragraph, "(6)" at the beginning of the fifth paragraph, and "(7)" at the beginning of the sixth paragraph.

SEC. 426. The seventh paragraph of section 16 of the Interstate Commerce Act is hereby amended to read as follows:

"(8) Any carrier, any officer, representative, or agent of a carrier, or any receiver, trustee, lessee, or agent of either of them, who knowingly fails or neglects to obey any order made under the provisions of sections 3, 13, or 15 of this Act shall forfeit to the United States the sum of $5,000 for each offense. Every distinct violation shall be a separate offense, and in case of a continuing violation each day shall be deemed a separate offense."

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SEC. 427. The eighth and ninth paragraphs of section 16 of the Interstate Commerce Act are hereby amended by inserting "(9)" at the beginning of the eighth paragraph and "(10)" at the beginning of the ninth paragraph.

SEC. 428. The tenth paragraph of section 16 of the Interstate Commerce Act is hereby amended to read as follows:

"(11) The Commission may employ such attorneys as it finds necessary for proper legal aid and service of the Commission or its members in the conduct of their work, or for proper representation of the public interests in investigations made by it or cases or proceedings pending before it, whether at the Commission's own instance or upon complaint, or to appear for or represent the Commission in any case in court; and the expenses of such employment shall be paid out of the appropriation for the Commission."

SEC. 429. The eleventh and twelfth paragraphs of section 16 of the Interstate Commerce Act are hereby amended by inserting "(12)" at the beginning of the eleventh paragraph and "(13)" at the beginning of the twelfth paragraph.

SEC. 430. Section 17 of the Interstate Commerce Act is hereby amended by inserting "(1)" after the section number at the beginning of the first paragraph.

SEC. 431. The second paragraph of section 17 of the Interstate Commerce Act is hereby amended to read as follows:

"(2) The Commission is hereby authorized by its order to divide the members thereof into as many divisions (each to consist of not less than three members) as it may deem necessary, which may be changed from time to time. Such divisions shall be denominated, respectively, division one, division two, and so forth. Any Commissioner may be assigned to and may serve upon such division or divisions as the Commission may direct, and the senior in service of the Commissioners constituting any of said divisions shall act as chairman thereof. In case of vacancy in any division, or of absence or inability to serve thereon of any Commissioner thereto assigned, the chairman of the Commission or any Commissioner designated by him for that purpose, may temporarily serve on said division until the Commission shall otherwise order."

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SEC. 432. The third and fourth paragraphs of section 17 of the Interstate Commerce Act are hereby amended by inserting "(3)" at the beginning of the third paragraph, and "(4)" at the beginning of the fourth paragraph.

The fifth and sixth paragraphs of such section are hereby repealed.

The seventh paragraph of such section is hereby amended by inserting "(5)" at the beginning of such paragraph.

SEC. 433. Section 18 of the Interstate Commerce Act is hereby amended by inserting "(1)" after the section number at the beginning of the first paragraph, and "(2)" at the beginning of the second paragraph.

Section 19a of the Interstate Commerce Act is hereby amended by inserting "(a)" after the section number at the beginning of the first paragraph, "(b)" at the beginning of the second paragraph, "(c)" at the beginning of the seventh paragraph, "(d)" at the beginning of the eighth paragraph, "(e)" at the beginning of the ninth paragraph, "(f)" at the beginning of the tenth paragraph, "(g)" at the beginning of the eleventh paragraph, "(h)" at the beginning of the twelfth paragraph, "(i)" at the beginning of the thirteenth paragraph, "(j)" at the beginning of the fourteenth paragraph, "(k)" at the beginning of the fifteenth paragraph, and "(l)" at the beginning of the sixteenth paragraph.

SEC. 434. Section 20 of the Interstate Commerce Act is hereby amended by inserting "(1)" after the section number at the beginning of the first paragraph, "(2)" at the beginning of the second paragraph, "(3)" at the beginning of the third paragraph, and "(4)" at the beginning of the fourth paragraph.

SEC. 435. The fifth paragraph of section 20 of the Interstate Commerce Act is hereby amended to read as follows:

"(5) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys. The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of deprecia-

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tion which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this Act shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. The Commission shall at all times have access to all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by carriers subject to this Act, and the provisions of this section respecting the preservation and destruction of books, papers, and documents shall apply thereto, and it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed or approved by the Commission, and it may employ special agents or examiners, who shall have authority under the order of the Commission to inspect and examine any and all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by such carriers. This provision shall apply to receivers of carriers and operating trustees. The provisions of this section shall also apply to all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, kept during the period of Federal control, and placed by the President in the custody of carriers subject to this Act."

SEC. 436. The sixth paragraph of section 20 of the Interstate Commerce Act is hereby amended by inserting "(6)" at the beginning of such paragraph.

The seventh paragraph of section 20 of the Interstate Commerce Act is hereby amended by striking out "Par. 7," at the beginning of such paragraph and inserting "(7)" in lieu thereof.

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The eighth to twelfth paragraphs, inclusive, of section 20 of the Interstate Commerce Act are hereby amended by inserting "(8)" at the beginning of the eighth paragraph, "(9)" at the beginning of the ninth paragraph, "(10)" at the beginning of the tenth paragraph, "(11)" at the beginning of the eleventh paragraph, and "(12)" at the beginning of the twelfth paragraph.

SEC. 437. The eleventh paragraph of section 20 of the Interstate Commerce Act is hereby amended by inserting immediately before the first proviso thereof the following:

"*Provided*, That if the loss, damage, or injury occurs while the property is in the custody of a carrier by water the liability of such carrier shall be determined by and under the laws and regulations applicable to transportation by water, and the liability of the initial carrier shall be the same as that of such carrier by water."

SEC. 438. The third proviso of the eleventh paragraph of section 20 of the Interstate Commerce Act (not counting the proviso added by section 437 of this Act) is hereby amended to read as follows:

"*Provided further*, That it shall be unlawful for any such common carrier to provide by rule, contract, regulation, or otherwise a shorter period for giving notice of claims than ninety days, for the filing of claims than four months, and for the institution of suits than two years, such period for institution of suits to be computed from the day when notice in writing is given by the carrier to the claimant that the carrier has disallowed the claim or any part or parts thereof specified in the notice."

SEC. 439. The Interstate Commerce Act is further amended by inserting therein a new section between section 20 and section 21, to be designated section 20a, and to read as follows:

"SEC. 20a. (1) That as used in this section the term 'carrier' means a common carrier by railroad (except a street, suburban, or interurban electric railway which is not operated as a part of a general steam railroad system of transportation) which is subject to this Act, or any corporation organized for the purpose of engaging in transportation by railroad subject to this Act.

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"(2) From and after one hundred and twenty days after this section takes effect it shall be unlawful for any carrier to issue any share of capital stock or any bond or other evidence of interest in or indebtedness of the carrier (hereinafter in this section collectively termed 'securities') or to assume any obligation or liability as lessor, lessee, guarantor, indorser, surety, or otherwise, in respect of the securities of any other person, natural or artificial, even though permitted by the authority creating the carrier corporation, unless and until, and then only to the extent that, upon application by the carrier, and after investigation by the Commission of the purposes and uses of the proposed issue and the proceeds thereof, or of the proposed assumption of obligation or liability in respect of the securities of any other person, natural or artificial, the Commission by order authorizes such issue or assumption. The Commission shall make such order only if it finds that such issue or assumption: (a) is for some lawful object within its corporate purposes, and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service, and (b) is reasonably necessary and appropriate for such purpose.

"(3) The Commission shall have power by its order to grant or deny the application as made, or to grant it in part and deny it in part, or to grant it with such modifications and upon such terms and conditions as the Commission may deem necessary or appropriate in the premises, and may from time to time, for good cause shown, make such supplemental orders in the premises as it may deem necessary or appropriate, and may by any such supplemental order modify the provisions of any previous order as to the particular purposes, uses, and extent to which, or the conditions under which, any securities so theretofore authorized or the proceeds thereof may be applied, subject always to the requirements of the foregoing paragraph (2).

"(4) Every application for authority shall be made in such form and contain such matters as the Commission may prescribe. Every such application, as also every certificate of notification hereinafter provided for, shall be made under oath, signed and filed on behalf of the carrier by its

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president, a vice president, auditor, comptroller, or other executive officer having knowledge of the matters therein set forth and duly designated for that purpose by the carrier.

"(5) Whenever any securities set forth and described in any application for authority or certificate of notification as pledged or held unencumbered in the treasury of the carrier shall, subsequent to the filing of such application or certificate, be sold, pledged, repledged, or otherwise disposed of by the carrier, such carrier shall, within ten days after such sale, pledge, repledge, or other disposition, file with the Commission a certificate of notification to that effect, setting forth therein all such facts as may be required by the Commission.

"(6) Upon receipt of any such application for authority the Commission shall cause notice thereof to be given to and a copy filed with the governor of each State in which the applicant carrier operates. The railroad commisions, public service or utilities commissions, or other appropriate State authorities of the State shall have the right to make before the Commission such representations as they may deem just and proper for preserving and conserving the rights and interests of their people and the States, respectively, involved in such proceeding. The Commission may hold hearings, if it sees fit, to enable it to determine its decision upon the application for authority.

"(7) The jurisdiction conferred upon the Commission by this section shall be exclusive and plenary, and a carrier may issue securities and assume obligations or liabilities in accordance with the provisions of this section without securing approval other than as specified herein.

"(8) Nothing herein shall be construed to imply any guaranty or obligation as to such securities on the part of the United States.

"(9) The foregoing provisions of this section shall not apply to notes to be issued by the carrier maturing not more than two years after the date thereof and aggregating (together with all other then outstanding notes of a maturity of two years or less) not more than 5 per centum of the par value of the securities of the carrier then outstanding. In the case of securities having no par value, the par value for the purposes of this paragraph shall be the fair market value

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as of the date of issue. Within ten days after the making of such notes the carrier issuing the same shall file with the Commission a certificate of notification, in such form as may from time to time be determined and prescribed by the Commission, setting forth as nearly as may be the same matters as those required in respect of applications for authority to issue other securities: *Provided*, That in any subsequent funding of such notes the provisions of this section respecting other securities shall apply.

"(10) The Commission shall require periodical or special reports from each carrier hereafter issuing any securities, including such notes, which shall show, in such detail as the Commission may require, the disposition made of such securities and the application of the proceeds thereof.

"(11) Any security issued or any obligation or liability assumed by a carrier, for which under the provisions of this section the authorization of the Commission is required, shall be void, if issued or assumed without such authorization therefor having first been obtained, or if issued or assumed contrary to any term or condition of such order of authorization as modified by any order supplemental thereto entered prior to such issuance or assumption; but no security issued or obligation or liability assumed in accordance with all the terms and conditions of such an order of authorization therefor as modified by any order supplemental thereto entered prior to such issuance or assumption, shall be rendered void because of failure to comply with any provision of this section relating to procedure and other matters preceding the entry of such order of authorization. If any security so made void or any security in respect to which the assumption of obligation or liability is so made void, is acquired by any person for value and in good faith and without notice that the issue or assumption is void, such person may in a suit or action in any court of competent jurisdiction hold jointly and severally liable for the full amount of the damage sustained by him in respect thereof, the carrier which issued the security so made void, or assumed the obligation or liability so made void, and its directors, officers, attorneys, and other agents, who participated in any way in the authorizing, issuing, hypothecating, or selling of the security so made void or in the authorizing of the assumption of the obligation or lia-

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bility so made void. In case any security so made void was directly acquired from the carrier issuing it the holder may at his option rescind the transaction and upon the surrender of the security recover the consideration given therefor. Any director, officer, attorney, or agent of the carrier who knowingly assents to or concurs in any issue of securities or assumptions of obligation or liability forbidden by this section, or any sale or other disposition of securities contrary to the provisions of the Commission's order or orders in the premises, or any application not authorized by the Commission of the funds derived by the carrier through such sale or other disposition of such securities, shall be guilty of a misdemeanor and upon conviction shall be punished by a fine of not less than $1,000 nor more than $10,000, or by imprisonment for not less than one year nor more than three years, or by both such fine and imprisonment, in the discretion of the court.

"(12) After December 31, 1921, it shall be unlawful for any person to hold the position of officer or director of more than one carrier, unless such holding shall have been authorized by order of the Commission, upon due showing, in form and manner prescribed by the Commission, that neither public nor private interests will be adversely affected thereby. After this section takes effect it shall be unlawful for any officer or director of any carrier to receive for his own benefit, directly or indirectly, any money or thing of value in respect of the negotiation, hypothecation, or sale of any securities issued or to be issued by such carrier, or to share in any of the proceeds thereof, or to participate in the making or paying of any dividends of an operating carrier from any funds properly included in capital account. Any violation of these provisions shall be a misdemeanor, and on conviction in any United States court having jurisdiction shall be punished by a fine of not less than $1,000 nor more than $10,000, or by imprisonment for not less than one year nor more than three years, or by both such fine and imprisonment, in the discretion of the court."

SEC. 440. Section 24 of the Interstate Commerce Act is hereby amended to read as follows:

"SEC. 24. That the Commission is hereby enlarged so as to consist of eleven members, with terms of seven years, and

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each shall receive $12,000 compensation annually. The qualifications of the members and the manner of payment of their salaries shall be as already provided by law. Such enlargement of the Commission shall be accomplished through appointment by the President, by and with the advice and consent of the Senate, of two additional Interstate Commerce Commissioners, one for a term expiring December 31, 1923, and one for a term expiring December 31, 1924. The terms of the present commissioners, or of any successor appointed to fill a vacancy caused by the death or resignation of any of the present commissioners, shall expire as heretofore provided by law. Their successors and the successors of the additional commissioners herein provided for shall be appointed for the full term of seven years, except that any person appointed to fill a vacancy shall be appointed only for the unexpired term of the commissioner whom he shall succeed. Not more than six commissioners shall be appointed from the same political party. Hereafter the salary of the secretary of the Commission shall be $7,500 a year."

SEC. 441. The Interstate Commerce Act is hereby further amended by adding at the end thereof three new sections, to read as follows:

"SEC. 25 (1) That every common carrier by water in foreign commerce, whose vessels are registered under the laws of the United States, shall file with the Commission, within thirty days after this section becomes effective and regularly thereafter as changes are made, a schedule or schedules showing for each of its steam vessels intended to load general cargo at ports in the United States for foreign destinations (a) the ports of loading, (b) the dates upon which such vessels will commence to receive freight and dates of sailing, (c) the route and itinerary such vessels will follow and the ports of call for which cargo will be carried.

"(2) Upon application of any shipper a carrier by railroad shall make request for, and the carrier by water shall upon receipt of such request name, a specific rate applying for such sailing, and upon such commodity as shall be embraced in the inquiry, and shall name in connection with such rate, port charges, if any, which accrue in addition to the vessel's rates and are not otherwise published by the

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railway as in addition to or absorbed in the railway rate. Vessel rates, if conditioned upon quantity of shipment, must be so stated and separate rates may be provided for carload and less than carload shipments. The carrier by water, upon advices from a carrier by railroad, stating that the quoted rate is firmly accepted as applying upon a specifically named quantity of any commodity, shall, subject to such conditions as the Commission by regulation may prescribe, make firm reservation from unsold space in such steam vessel as shall be required for its transportation and shall so advise the carrier by railroad, in which advices shall be included the latest available information as to prospective sailing date of such vessel.

"(3) As the matters so required to be stated in such schedule or schedules are changed or modified from time to time, the carrier shall file with the Commission such changes or modifications as early as practicable after such modification is ascertained. The Commission is authorized to make and publish regulations not inconsistent herewith governing the manner and form in which such carriers are to comply with the foregoing provisions. The Commission shall cause to be published in compact form, for the information of shippers of commodities throughout the country, the substance of such schedules, and furnish such publications to all railway carriers subject to this Act, in such quantities that railway carriers may supply to each of their agents who receive commodities for shipment in such cities and towns as may be specified by the Commission, a copy of said publication; the intent being that each shipping community sufficiently important, from the standpoint of the export trade, to be so specified by the Commission shall have opportunity to know the sailings and routes, and to ascertain the transportation charges of such vessels engaged in foreign commerce. Each railway carrier to which such publication is furnished by the Commission is hereby required to distribute the same as aforesaid and to maintain such publication as it is issued from time to time, in the hands of its agents. The Commission is authorized to make such rules and regulations not inconsistent herewith respecting the distribution and maintenance of such publications in the several communities so specified as will further the intent of this section.

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"(4) When any consignor delivers a shipment of property to any of the places so specified by the Commission, to be delivered by a railway carrier to one of the vessels upon which space has been reserved at a specified rate previously ascertained, as provided herein, for the transportation by water from and for a port named in the aforesaid schedule, the railway carrier shall issue a through bill of lading to the point of destination. Such bill of lading shall name separately the charge to be paid for the railway transportation, water transportation, and port charges, if any, not included in the rail or water transportation charge; but the carrier by railroad shall not be liable to the consignor, consignee, or other person interested in the shipment after its delivery to the vessel. The Commission shall, in such manner as will preserve for the carrier by water the protection of limited liability provided by law, make such rules and regulations not inconsistent herewith as will prescribe the form of such through bill of lading. In all such cases it shall be the duty of the carrier by railroad to deliver such shipment to the vessel as a part of its undertaking as a common carrier.

"(5) The issuance of a through bill of lading covering shipments provided for herein shall not be held to constitute 'an arrangement for continuous carriage or shipment' within the meaning of this Act.

"SEC. 26. That the Commission may, after investigation, order any carrier by railroad subject to this Act, within a time specified in the order, to install automatic train-stop or train-control devices or other safety devices, which comply with specifications and requirements prescribed by the Commission, upon the whole or any part of its railroad, such order to be issued and published at least two years before the date specified for its fulfillment: *Provided*, That a carrier shall not be held to be negligent because of its failure to install such devices upon a portion of its railroad not included in the order; and any action arising because of an accident happening upon such portion of its railroad shall be determined without consideration of the use of such devices upon another portion of its railroad. Any common carrier which refuses or neglects to comply with any order of the Commission made under the authority conferred by this section shall be liable to a penalty of $100 for each day that

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such refusal or neglect continues, which shall accrue to the United States, and may be recovered in a civil action brought by the United States.

"SEC. 27. That this Act may be cited as the 'Interstate Commerce Act.' "

Title V.—Miscellaneous Provisions

SEC. 500. It is hereby declared to be the policy of Congress to promote, encourage, and develop water transportation, service, and facilities in connection with the commerce of the United States, and to foster and preserve in full vigor both rail and water transportation.

It shall be the duty of the Secretary of War, with the object of promoting, encouraging, and developing inland waterway transportation facilities in connection with the commerce of the United States, to investigate the appropriate types of boats suitable for different classes of such waterways; to investigate the subject of water terminals, both for inland waterway traffic and for through traffic by water and rail, including the necessary docks, warehouses, apparatus, equipment, and appliances in connection therewith, and also railroad spurs and switches connecting with such terminals, with a view to devising the types most appropriate for different locations, and for the more expeditious and economical transfer or interchange of passengers or property between carriers by water and carriers by rail; to advise with communities, cities, and towns regarding the appropriate location of such terminals, and to cooperate with them in the preparation of plans for suitable terminal facilities; to investigate the existing status of water transportation upon the different inland waterways of the country, with a view to determining whether such waterways are being utilized to the extent of their capacity, and to what extent they are meeting the demands of traffic, and whether the water carriers utilizing such waterways are interchanging traffic with the railroads; and to investigate any other matter that may tend to promote and encourage inland water transportation. It shall also be the province and duty of the Secretary of War to compile, publish, and distribute, from time to time, such useful statistics, data, and information concerning

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transportation on inland waterways as he may deem to be of value to the commercial interests of the country.

The words "inland waterway" as used in this section shall be construed to include the Great Lakes.

SEC. 501. The effective date on and after which the provisions of section 10 of the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes," approved October 15, 1914, shall become and be effective is hereby deferred and extended to January 1, 1921: *Provided*, That such extension shall not apply in the case of any corporation organized after January 12, 1918.

SEC. 502. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid such judgment shall not affect, impair, or invalidate the remainder of the Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment has been rendered.

Approved February 28, 1920

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What the Items of a Bank Statement Mean

Guaranty Trust Company
of New York

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What the Items of a Bank Statement Mean

By STUART H. PATTERSON
Comptroller, Guaranty Trust Company of New York

Guaranty Trust Company of New York
140 Broadway

FIFTH AVENUE OFFICE
Fifth Avenue and 44th Street

MADISON AVENUE OFFICE
Madison Avenue and 60th Street

GRAND STREET OFFICE
268 Grand Street

LONDON LIVERPOOL PARIS HAVRE
BRUSSELS CONSTANTINOPLE

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What the Items of a Bank Statement Mean

NATIONAL BANKS are required to publish financial statements five times a year, and in many States such statements must be published by State Banks and Trust Companies as often as four times a year. Although bank statements, in detail, are published in certain officially designated newspapers, the customary form of publication is a condensed statement, of which the following statement of Guaranty Trust Company of New York as of September 30, 1920, is typical:

RESOURCES

Cash—On Hand and in Banks	$111,306,421.14
Exchanges for Clearing House	70,921,949.74
Loans and Bills Purchased	521,477,002.28
U. S. Government Bonds and Certificates	33,262,404.09
Public Securities	30,405,706.50
Other Securities	45,154,659.21
Bonds and Mortgages	2,335,950.00
Foreign Exchange	21,446,069.24
Credits Granted on Acceptances	63,684,741.70
Real Estate	8,529,075.37
Accrued Interest and Accounts Receivable	12,281,276.95
	$920,805,256.22

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LIABILITIES

Capital	$25,000,000.00
Surplus Fund	25,000,000.00
Undivided Profits	10,754,227.55
	$60,754,227.55
Notes and Bills Rediscounted with Federal Reserve Bank	19,050,000.00
Notes Secured by Liberty Bonds Rediscounted with Federal Reserve Bank	24,917,200.22
Due Federal Reserve Bank against U. S. Government Obligations	5,000,000.00
Outstanding Dividend Checks	1,043,540.50
Outstanding Treasurer's Checks	30,617,242.94
Sundry Foreign Accounts	14,195,250.19
Acceptances—New York Office	49,974,979.70
Foreign Offices	13,709,762.00
Accrued Interest Payable and Reserves for Taxes, Expenses, etc	8,982,767.52
Deposits	692,560,285.60
	$920,805,256.22

Capital, Surplus, Undivided Profits

In any financial statement the "Resources" give a description and valuation of the assets available for meeting liabilities. The fact that the total of the liabilities is exactly equal to the total resources is due to the fact that the excess of resources over liabilities to various creditors and depositors, consisting of Capital, Surplus and Undivided Profits, belongs to the stockholders, and, therefore, is shown on the statement as a liability, thus equalizing both sides.

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To Meet Liabilities

In the case of liquidation, however, stockholders do not receive anything until all other liabilities have been paid in full. Under Federal law, and the banking laws of most States, stockholders of banks and trust companies are also liable to an additional assessment, if necessary to meet liabilities, equal to the par value of their stock. In the foregoing statement the stockholders' investment is $60,754,227.55, and as their additional liability, equal to the par value of the capital stock, is $25,000,000, there is a protection for depositors and other creditors equivalent to $85,754,227.55. In other words, all assets could be liquidated for that much less than the valuations shown on the statement, and there would still be sufficient to pay all depositors and creditors in full.

Additional Protection

Bank depositors, however, are usually further protected by conservative institutions carrying bank buildings and real estate at cost, or less than cost, even though the market value may have increased materially, and in writing off the cost of furniture and fixtures to Profit and Loss or Expense, also in creating reserves for possible bad debts or decrease of value of investments in securities through market fluctuations. This policy

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naturally creates dormant reserves, which, in case of liquidation, should make the assets realize more than is shown on the statement.

The deposits of a commercial bank are subject to check, and, to enable it to meet current demands, a certain amount must be kept in the form of cash, and its investments should be of the self-liquidating kind and of short maturity.

Total Cash Position

It will be noted from the statement that "Cash—On hand and in Banks," the latter being subject to check, amounts to $111,306,421.14, and "Exchanges for Clearing House," representing checks which will be settled through the Clearing House the following morning, amount to $70,921,949.74 or a total cash position of $182,228,370.88. This is much more than sufficient to meet the daily demands of depositors having total deposits of $692,560,285.60, but, under Federal and State laws, bankers are required to keep a certain minimum cash reserve on hand or with banks.

Funds for Meeting Demands

The largest single item of investment represents "Loans and Bills Purchased," amounting to $521,477,002.28. Such loans and bills are usually for demand or of 90 days' dura-

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tion or less, and, as loans are being made daily, there are daily maturities which supply the bank with funds for meeting demands against it, or for making new loans. As far as possible, the loans are made eligible for rediscount at the Federal Reserve Bank.

United States Obligations

The banks of the country were a most important factor in war financing, both in purchasing United States Government Bonds and Certificates for their own account and in lending to customers money with which to purchase Government bonds. The $33,262,404.09 United States obligations shown in the statement represent the portion held by the Company and are used principally for capital investment purposes. It is also customary to carry some of the bank funds in other investment securities to diversify the resources and produce a more even rate of earnings under varying conditions.

Investment in Securities

Many banks have well-equipped bond departments which do an investment banking business and when such a department is maintained the amount invested in securities is, of course, much larger than in the case of a bank doing a purely commercial business. In the statement shown the total investment

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in securities is $108,822,769.80. Some of these are short-term notes, while others are long-term bonds, but high grade securities are always readily marketable and can be realized upon in a comparatively short time if funds are required for other purposes. "Bonds and Mortgages," representing loans on real estate, usually are not carried in large amounts by banks doing a commercial business.

Foreign Exchange

"Foreign Exchange" of $21,446,069.24 in the statement is principally items in transit representing drafts, bills of exchange, etc., which have been purchased in the ordinary course of business. A bank doing an international business is called upon by its bank and other depositors for funds to make payments abroad, and such funds are principally acquired by purchasing from exporters the bills that they draw against shipments abroad.

Credit Granted On Acceptances

The Resources side of the statement shows "Credit Granted on Acceptances," $63,684,741.70, and it will be noted that the total of "Acceptances" on the liability side is exactly the same amount. When a bank accepts a draft drawn upon it in connection with a Commercial Letter of Credit, or otherwise, it assumes a liability to honor the acceptance at

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maturity, thus creating a liability which must appear in the statement, while, against this liability, the bank holds the obligations of its customers to provide the funds at maturity, and this obligation of the bank's customers appears in the statement under the caption "Credit Granted on Acceptances." Other liabilities of the bank in connection with international transactions are reported under "Sundry Foreign Accounts," as in the statement shown $14,195,250.19.

Rediscounts with Federal Reserve Bank

Prior to the enactment of the Federal Reserve law, the means of securing credit beyond a given point were very much restricted and consequently required a much greater cash reserve to provide against contingencies. Under the present law the cash reserves are lower and a bank can rediscount eligible notes and bills of its customers with the Federal Reserve Bank, thereby providing greater elasticity in time of need and releasing for circulation a large amount of cash which was previously locked up to meet contingencies which might arise. As rediscounting is subject to the restrictions contained in the Federal Reserve Act, and regulations promulgated by the Federal Reserve Board, there are limitations, consistent with safe and conservative banking, on the use that can be made of

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these rediscount facilities. In this statement rediscounts total $43,967,200.22 or only slightly more than 8% of the total of "Loans and Bills Purchased," while of the amount borrowed $24,917,200.22 represent rediscount of loans made to customers carrying Liberty Loan Bonds.

Outstanding Dividend and Treasurers' Checks

Outstanding Dividend Checks of $1,043,540.50 represent dividend checks of the Company payable on September 30th not yet been presented for payment; and "Outstanding Treasurer's Checks" of $30,617,242.94 represent checks on the Company that have been issued to customers who desire to make remittances in that manner, checks issued for the proceeds of loans, and those issued in payment of company liabilities and expenses.

Accrued Interest and Accounts Receivable

In order to show a true statement of condition at any time, it is necessary to accrue interest, expenses, taxes, etc., as of the date of the statement. "Accrued Interest and Accounts Receivable" are shown in the Resources side of the statement as $12,281,276.95, and "Accrued Interest Payable and Reserves for Taxes, Expenses, Etc." on the

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Liabilities side as $8,982,767.52. In other words, resources accrued to the date of the statement, but not collected, exceed accrued liabilities by $3,298,509.43.

Deposits

The largest single item in the liabilities of any bank is, of course, "Deposits," which in this statement are shown as $692,560,285.60, and which represent both time and demand deposits, trust funds, deposits, etc. The amount of reserve held against time deposits is less than that held for demand deposits and, consequently, money on time permits of a higher rate of interest to the depositor.

Foundations of Strongest Banks

Bank statements show the financial condition of the bank at any given date, but a comparison with previous statements is necessary to ascertain the progress that is being made. In addition to examining statements of his bank, however, a depositor should inquire into its administration, its management, and the service that it renders. Sound policies, a broad vision of modern financial needs, efficient management, and facilities for serving its depositors in their financial affairs are the foundations on which the strongest banks are built.

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The Care of Your Securities

Guaranty Trust Company
of New York

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The Care of Your Securities

A service for individuals, fiduciaries, firms, corporations, and others owning securities

Guaranty Trust Company of New York

140 Broadway

FIFTH AVENUE OFFICE, Fifth Ave. and 44th St.
MADISON AVENUE OFFICE, Madison Ave. and 60th St.
GRAND STREET OFFICE, 268 Grand Street

Capital and Surplus - - - -	$50,000,000
Resources more than - - - -	$800,000,000

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MAR 30 1921

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The Care of Your Securities

WHEN you deposit securities in a safe deposit box, the duty of the renting corporation is merely to furnish adequate protection, and to permit only yourself or persons authorized by you to have access thereto.

The essential element of safety is provided, but the scope of the service is limited.

Experience has shown that many persons are inclined to postpone, from time to time, visiting their safe deposit boxes to collect the income which has become due on securities, or the principal of bonds which may have matured. Few persons realize that each day's failure to collect such income and principal results in a direct loss to them.

Your Financial Secretary

A SAFEKEEPING ACCOUNT not only provides an *equal element* of safety but also relieves you of the details of the care and custody of your securities. It assures the

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collection of income and the principal of maturing investments without delay and consequent loss of interest.

In opening a SAFEKEEPING ACCOUNT with us, you are, in effect, employing a responsible financial secretary, not only to relieve yourself of possible inconvenience and annoyance in connection with your securities, but at the same time to bring to your attention any facts or circumstances which may tend to affect the value of your holdings.

Freeing Yourself of Routine

Even though you may intend to give these matters close attention, your engagements may not permit you the time necessary to visit your safe deposit box, clip coupons, make out income tax certificates, and collect money due. Or you may be absent from the city, making it inconvenient, if not impossible, for you to attend to these details; nevertheless, your failure to do so may mean delay in the use and reinvestment of your money and consequent loss of interest.

By depositing securities with us in safekeeping, you are relieved (for a mod-

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erate fee) from all routine care, while at the same time you retain complete control of them.

Your securities are always available to you without your being present. You may direct their sale or transfer their ownership as readily as you may, by check, transfer money in a bank account.

Facts About Your Holdings

In accepting securities for safekeeping, we not only undertake to attend to all routine matters connected with their care, but also endeavor to inform you of facts of interest regarding them.

You may not know, for example, that a bond which you hold contains a sinking fund provision, which may permit you to offer it for sale to the company issuing it —often at a premium. You may not know that another bond has been "called" for redemption prior to its maturity; yet if it has been so "called," you will not receive any interest beyond the date set for its redemption. You may not have learned that a protective committee has been formed to care for the interests of

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a stock or bond issue of which you are a holder. Such information is especially of value in the case of a default occurring under the terms of a corporate mortgage given to secure a bond which you own—such default making it advisable for all bondholders to act together for the protection of their common interests.

You may not have had an opportunity to examine the indenture under which a particular bond was issued to ascertain whether such a bond may be converted into stock of the same or a different corporation. Such conversions can often be made at attractive prices, due to fluctuating market conditions. Again, information that a company has issued "rights" to its stockholders, entitling them to subscribe to new securities may be of great value to you.

Review of Your Investments

As economic conditions are constantly changing, the far-sighted investor takes the precaution of having his securities carefully analyzed by experts, from time to time, in order to determine whether varying conditions have so affected his

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holdings that changes or readjustments may be desirable. We are prepared at all times to analyze a customer's securities, upon request, and to recommend such changes in his holdings as, in our judgment, are advisable in each particular case.

Details of Service

Under a SAFEKEEPING ACCOUNT, the Guaranty Trust Company of New York:

1 Accepts the custody of securities, issuing its receipt therefor.

2 Renders, when requested, periodical statements of securities held.

3 Collects income from securities held.

4 Collects the principal of matured investments.

5 Notifies you in advance of the maturity of any of your holdings, in order that you may arrange for reinvestment.

6 Prepares and executes as agent, under power of attorney, all declarations (certificates) of ownership required under the Federal Income Tax Law for the collection of interest and dividends of foreign corporations.

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7 Attends, at your request, to the sale or purchase of such securities as you may direct.

8 Reports upon the condition of investments when requested.

9 Watches for and endeavors to inform you concerning:

- Called bonds.
- Rights to convert bonds into stock;
- Rights to subscribe to new issues of bonds and stock;
- Extraordinary, increased, reduced, and passed dividends;
- Appointment of receivers;
- Appointment of protective and reorganization committees;
- Opportunities to sell bonds to sinking funds.

10 Receives for safekeeping, securities held by executors, administrators, trustees, guardians, and committees for incompetent persons, under proper instructions affecting investments and reinvestments, collecting and disbursing income, and keeping the requisite schedules and accounts.

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11 Receives deposits of securities from executors, administrators, trustees, and guardians, made for the purpose of reducing the bonds which they are required to file with the Surrogate. Such deposits are made on order of the Surrogate, and may be withdrawn only on further order of the Surrogate.

12 Attends to the transfer of stocks and registered bonds.

The Care of Your Real Estate

In order to afford service for all of your holdings, the Guaranty Trust Company, in addition to caring for your securities, will look after your real estate: lease or sell the same, collect the rents, attend to taxes and assessments, insurance, repairs, and perform the other duties involved in the proper management of such property.

While we attend to the details which have been mentioned, we endeavor to make our service broad and comprehensive enough to adapt it to the particular needs of each individual.

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Guaranty Trust Company of New York

Acts in every fiduciary capacity:

Executor or trustee under wills

Administrator with or without the will annexed

Guardian

Trustee under deeds of trust

Receiver

Committee

Assignee

Depositary of moneys paid into court

Depositary in escrow of cash, securities or agreements

Depositary under syndicate and reorganization agreements

Trustee under mortgages

Registrar and transfer agent

Custodian of securities

Management of real estate

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Guaranty Trust Company of New York

140 Broadway

Fifth Avenue Office
Fifth Avenue and Forty-fourth Street

Madison Avenue Office
Madison Avenue and Sixtieth Street

Grand Street Office
268 Grand Street

London Offices
32 Lombard Street, E. C.
50 Pall Mall

Paris Office
1 and 3 Rue des Italiens

Brussels Office
158 Rue Royale

Liverpool Office
27 Cotton Exchange Buildings

Havre Office
122 Boulevard de Strasbourg

Constantinople Office
21 Rue Kiourkdjiler, Galata

Capital and Surplus..... $50,000,000
Resources more than..... $800,000,000

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Trust Service for Corporations

Guaranty Trust Company
of New York

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Trust Service for Corporations

Guaranty Trust Company of New York

140 Broadway

FIFTH AVENUE OFFICE, Fifth Ave. and 44th St.
MADISON AVENUE OFFICE, Madison Ave. and 60th St.
GRAND STREET OFFICE, 268 Grand Street

Capital and Surplus - - - - $50,000,000
Resources more than - - - - $800,000,000

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Foreword

THROUGH its complete fiduciary facilities, the Guaranty Trust Company of New York renders a service to corporations which is a distinct aid in the safe and expeditious transaction of certain important phases of modern business.

Some of these functions, such as those of transfer agent, registrar, disbursing agent, trustee, agent under financial readjustments, and custodian of securities, are outlined in these pages. This booklet is necessarily only a brief presentation of the subject, but the officers of the Company are ready at all times to describe in detail, through personal call or by correspondence, the scope of our services and their advantages to your company.

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Trust Service for Corporations

Transfer Agent and Registrar

WHEN a company has passed beyond the stage of a "close corporation," and its securities are actively bought and sold, it is an advantage and economy to the company itself, and a service to its shareholders and investors generally, to have a New York *transfer agent and registrar*.

New York, the financial center of the United States, is naturally the country's chief market for stocks and bonds. A company which wishes to establish its securities in this great market must provide facilities for their registration and their immediate transfer and delivery, and a trust company, because of its experience and its organized machinery for such work, is usually chosen.

As *transfer agent* for a corporation, the trust company keeps the stock ledger, which is a record of the name, address,

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and holdings of each stockholder. It also issues and countersigns stock certificates. This may be done on the surrender of old certificates, as when a stockholder sells his holdings to another person, or it may be done as a matter of original issue, when a corporation is first organized, a stock dividend declared, or the capitalization increased.

But the trust company does more than these mechanical operations. The transferring of stock under the various conditions which arise is a matter of great importance, as the duties of a transfer agent and the requirements for making transfers have become many and complex.

There has been much legislation on the subject, particularly affecting estates, whereby the transfer function is made of assistance to the Federal and State governments in the collection of inheritance and stamp taxes. The transfer agent, therefore, must have a thorough knowledge of all such legal requirements, and must exercise great care in connection with statutes of the various States covering appointments of guardians, administrators, and executors, as well as statutes

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relating to the replacement of lost certificates and to the present authority of a person signing under a power of attorney. Then, there are always possibilities of forgery to be guarded against—forgery of the name of the corporation officer signing stock certificates, of the name of the holder of a certificate, or alteration in the number of shares which a certificate represents.

Few corporations care nowadays to assume the responsibilities in connection with the transfer of stock. They realize that in all these matters the trust company, with its fund of experience and its highly trained personnel, dealing daily with transfers and the problems arising in connection with them, is able to render competently and efficiently a most important service to the corporation, relieving it not alone from the burden of clerical work and supervision incident to the handling of transfers of ownership, but also lessening to a large extent its responsibility as to the legality of the transfer.

Under the rules of the New York market, a corporation whose stock is to be listed on the Exchange must have a

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registrar, and this registrar must be another corporation. Here again a trust company, by reason of its facilities for so acting, is generally selected.

It is obvious that when capital stock is issued every precaution must be taken to prevent the issuance of certificates for more than the authorized number of shares. This is the duty of the registrar —to see that at all times the number of shares outstanding, whether of the original certificates or of certificates issued in cases of transfers of ownership, does not exceed the number authorized. The registrar receives the certificates as they are issued by the transfer agent, determines if they are within the authorized limits of issue, countersigns them, makes the necessary entries in its records, and returns them to the transfer agent for delivery to the stockholder.

The widespread distribution of securities among the public and the necessity for surrounding their issuance with every safeguard make the functions of the registrar a service of no small importance. If the corporation issues its own stock and makes its own transfers, the services of a

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competent registrar are highly desirable as a check against over-issuance of stock, and many corporations avail themselves of this safeguard.

Co-Transfer Agent and Co-Registrar

It sometimes happens that a corporation at a distance from New York has a good proportion of its stock held locally, the rest being scattered. While the corporation is not unmindful of the benefits of a New York transfer agent and registrar, it may hesitate to take advantage of such services in the belief that it would be a convenience to their local stockholders to have the transfer agent near home. In such a case the interests of all stockholders can be served by the appointment of a local transfer agent and registrar and a New York *co-transfer agent* and *co-registrar*. Stockholders can then have their stock transferred at the point nearest them, as the agents and the registrars act interchangeably.

Paying Agent

Many corporations are profiting by the advantages of a New York *paying agent*

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for coupons and dividends. In these days when securities are so widely scattered throughout this and foreign countries, a central agency for the payment of interest and dividends is a matter of practical necessity.

The trust company is able to offer a distinct service to the corporation in the handling of these operations. Oftentimes the corporation will find the preparation of lists of stockholders entitled to dividends, the drawing of hundreds or thousands of checks, and their mailing at interest or dividend time, a considerable burden and inconvenience to its clerical force. But to the trust company, equipped with the latest mechanical devices and with a personnel trained in such work, these are matters of daily routine. The issuing corporation has then but one check to prepare—that to the trust company for the total amount—and is thus relieved of a vast mass of detail work.

The paying agent likewise under the direction of the corporation prepares and mails notices of meetings, proxies, and similar forms, and distributes to stockholders annual or other reports.

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Trustee

Whenever a corporation desires to issue mortgage bonds, debentures, collateral trust bonds, notes, secured or unsecured, equipment issues, either direct obligations or under the Philadelphia plan, this can best be done by a *trust indenture*, defining the terms under which such securities are issued. A trust company, by reason of its continued existence and years of experience, is thoroughly equipped to administer trusts of this nature.

Custody of Securities

Many corporations owning securities find it desirable to relieve their officers of the responsibility and routine labor incident to keeping securities in safe deposit boxes. This Company will hold securities in safekeeping; collect the coupons from bonds and dividends on stock; collect principal upon maturity; receive or make deliveries; execute, on instructions, orders to buy or sell; watch for called bonds, opportunities to sell to sinking funds, rights to subscribe to new stocks or bonds, increased, decreased or passed dividends, defaults, the forming of protec-

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tive committees, etc.; it will report when requested on the condition of investments; and it will attend to other details in connection with the routine care of securities.

Other Fiduciary Services

There is almost no limit to the services that the trust department of a well-organized trust company can render to a corporation and its security holders.

Consolidations and mergers of corporations, calling for the exchange of securities of one corporation for those of another, involve an enormous amount of detail and intricate operations, and the average corporation is not in a position to divert its energies from the business in which it is engaged to handle the various steps which must be taken care of.

The services of a trust company as depositary and agent are now a well-recognized necessity in any reorganization plan.

A trust company has the facilities and personnel available to receive deposits of stock from any number of holders, to pass upon transfers which may be involved, and to issue certificates of deposit pending

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the determination of whether the proposed action will meet with the approval of the stockholders of the companies interested.

If the plan relating to the consolidation or merger is declared operative, the certificates of deposit are exchanged for the new stock, which usually involves the distribution of fractional shares or dividend adjustments, and requires expert handling to prevent resultant complications.

A corporation may wish to offer its stock in exchange for the stock of another company: such an exchange can be put through by the trust department.

In the case of voluntary liquidation of a corporation, the trust department can perform the work and distribute the securities and cash.

When stockholders or bondholders desire to pool their interests in a committee under an agreement relating to some phase of a readjustment or reorganization, or to form a "protective committee" in the case of threatened insolvency, or to create a voting trust, the trust company can relieve such

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a committee of the physical handling of the securities.

In case a corporation is reorganizing, the trust company may receive the old securities, issue to the security holders its receipts, and, at the proper time, may redeem them for the new securities. It may also act as agent and relieve the corporation's officers and security holders of many details in connection with the refinancing.

Should it be desired to hold cash, securities, letters patent, deeds, contracts, formulas or other documents in escrow, the trust department handles the matter under a simple letter of instructions, or in some instances under an agreement.

In short, there is no stage in the existence of a corporation, from organization to dissolution, at which this Company is not able to be of decided assistance in fiduciary matters.

The Trust Department and the Transfer, Registration and Coupon Departments of this Company are exceptionally well qualified, by reason of the Company's half-century of service in the handling of many and varied transactions, to perform

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these various functions. Complicated problems constantly arise in the handling of such matters, and great responsibility is involved in solving them. The officers of this Company have the benefit of many precedents upon which to base their solutions of the out-of-the-ordinary questions. The suggestions which they are able to make have been of great assistance to many corporations. Our officers are always ready to confer with corporations which have such problems and to explain in detail how the agency services and business counsel of this Company can be of value to them.

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GUARANTY TRUST COMPANY
OF NEW YORK

Acts in every fiduciary capacity:

Executor or trustee under wills

Administrator with or without the will annexed

Guardian

Trustee under deeds of trust

Receiver

Committee

Assignee

Depositary of moneys paid into court

Depositary in escrow of cash, securities or agreements

Depositary under syndicate and reorganization agreements

Trustee under mortgages

Registrar and transfer agent

Custodian of securities

Management of real estate

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Voluntary Trusts

An Important Feature of the Service of a Trust Company

Guaranty Trust Company
of New York

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Voluntary Trusts

An Important Feature of the Service of a Trust Company

Guaranty Trust Company of New York

140 Broadway

FIFTH AVE. OFFICE
Fifth Ave. and 44th St.

MADISON AVE. OFFICE
Madison Ave. and 60th St.

GRAND STREET OFFICE
268 Grand Street

Capital and Surplus - - - - $50,000,000
Resources more than - - - - $800,000,000

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Voluntary Trusts

An Important Feature of the Service of a Trust Company*

MANY PERSONS wish during their lifetime to provide a regular income for perhaps a wife, son, daughter or other relative, or a charity, and at the same time not be burdened with the details incident to the accomplishing of those desires, such as the care of the securities, the cutting of coupons or collecting of other income, the reviewing of the character of the investments, the disbursing of the income, the keeping of books, the preparing and filing of income tax returns, etc. They can easily be relieved, at a small expense, of these burdens by means of a Voluntary Trust.

A review of existing trusts shows that the purposes for which such trusts have been created are many and varied. Some

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of them are: (1) Income payable to a wife during her life. (2) Income payable direct to children. (3) Income to be used for the education of an individual. (4) Income payable to the creator of the trust for the benefit of infant children. (5) Income payable to the creator of the trust for his own benefit. (6) Income payable to a charity. (7) To provide an income for an intended husband or wife. (8) To provide for a marriage settlement. (9) To provide income under a divorce decree or separation agreement. (10) To collect and dispose of life insurance.

In the making of definite arrangements of this kind, by means of a Voluntary Trust, the maker should consider: What provisions should be made in the event of the beneficiary's death? Is the trust to remain in force for some other person, or is it to revert to the maker? A trust can be made irrevocable, or the maker can retain the power to revoke. He can retain the power to modify the agreement. He can retain the power to increase the

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principal of the trust. He can retain control over the securities.

If the maker of the trust wishes to retain the right to specify the investment, he must use express language and relieve the trustee from any loss or depreciation arising from the trustee making investments under his direction other than those prescribed by law as legal.

Trustee Confined to Legal Investments

In the absence of instructions concerning the question of securities permitted to be held under the trust, the trustee must invest in what are termed legal investments. Generally speaking, legal investments are bonds of the United States Government, or any political sub-division thereof, first mortgages on real estate not to exceed 66⅔% of the appraised values, and other securities which correspond more or less with the investments which are legal for savings banks in the State of New York.

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The maker of the trust may leave the matter of investment entirely to the discretion of the trustee, giving the trustee immunity if such investments are made in the exercise of usual business discretion and good faith. The trust agreement should also provide in what securities, after the original investment, the trustee may invest and reinvest. It should also provide what should be done in the matter of amortization of premiums, stock dividends, reorganizations, and readjustments.

Two Classes of Beneficiaries

There may be two classes of beneficiaries under a Voluntary Trust—one who receives the income from the trust property during life and who is termed "life tenant" or "holder of the life estate," and one who is ultimately to receive the property itself at the death of the life tenant and who is termed "remainderman." A trust may also be so drawn that one person receives the income only, for

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a certain period, and ultimately, at a time stated in the trust agreement, the property itself.

The New York law very carefully recognizes the relations existing between the trustees and beneficiaries, or remaindermen, and carefully guards the interests of the beneficiary or remainderman. A trustee may not profit by his administration of the trust property other than by agreement. The trustee may not deal with himself. That is, he may not purchase property from himself for investment in the trust. The trustee must act with due diligence and in good faith, exercising the same care and intelligence that he would use in the transaction of his own business. For gross negligence, bad faith or for dishonesty, he may be at any time called to account.

Duration of a Trust

In New York State a trust must be based upon not more than two lives which are in being. Thus a trust may be created

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for one's wife and for one's living daughter, but the same property may not be held in trust for the wife and, upon the wife's death, in trust for the daughter, and upon the daughter's death in trust for another child. When the property has been held in trust for the second life, then the trust must terminate and the property pass to some person.

When the enjoyment of the trust passes is the test which determines in the State of New York whether or not an inheritance tax is payable. The inheritance tax is a tax upon the transfer of property and the right of enjoyment. In New York an absolute gift in trust during the maker's lifetime, the gift not being effective by the maker's death is not subject to an inheritance tax. If, however, the enjoyment or benefit of the trust passes upon the maker's death, the trust is as much subject to the inheritance tax as if it passed by will. The federal tax goes even further and provides that any gift made without consideration two years before

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the death of the grantor, may be subject to an inheritance tax as if the benefit and enjoyment were to pass after the maker's death.

There are two main points of difference between a Voluntary Trust and a trust created under a will. One is that the Voluntary Trust becomes operative at once, or at a specified time. A trust created under a will becomes operative only after the death of the testator or the person making the will. The other is in the method of the execution of the trust. The Voluntary Trust is executed in much the same manner as any other contract. That is, it is signed by the maker and accepted by the trustee before witnesses. A will is made only by the testator whose signature is witnessed by other persons.

Frequently a person's problems may require both a Voluntary Trust and a legal trust under a will. The wording in which trusts are created is in general purport the same whether expressed in Voluntary

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Trusts or in wills. The purposes for which, in law, Voluntary Trusts or trusts under a will may be created, also are practically identical. The same protection of law is given to beneficiaries under either kind of trust, the same restriction upon the object for which the trust may be created, and the same limitation upon the term for which it may exist, apply.

The general direction of a trust is that the trustee shall hold the property, to invest it, reinvest it and pay the income, after deducting all proper taxes, expenses and commissions of the trustee to the beneficiary, and upon the expiration of the trust, to turn the trust property over to the persons named to receive it under the provisions of the trust.

[The drafting of a trust agreement is a highly technical matter and it should be prepared with a careful observance of the laws of the State which will have jurisdiction over it, and each person intending to create a trust should see that it is referred to and drawn by his personal counsel.]

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Responsibility of the Trustee

In so vital a matter as the making of a trust which concerns the future of the maker and the beneficiaries, the maker should give serious consideration to the responsibility of the trustee who is to carry out his wishes. One of the strongest reasons for the selection of a Trust Company as trustee is that its financial responsibility is the best safeguard which beneficiaries under a trust can have. In case of any unlawful action on the part of the Trust Company, redress to the courts may be had, and in the event of a decision in favor of the beneficiary, the Trust Company's resources may be looked to for satisfaction. Another important feature of Trust Company service is that of its continuous existence. An individual trustee may be absent, or become incapacitated, or may die before the trust is completed. A Trust Company, on the other hand, maintains a permanent organization, its officers are always accessible, its existence is continuous.

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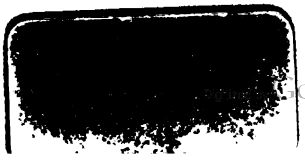
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